

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In re

DETERMINATION OF ROYALTY RATES
AND TERMS FOR MAKING AND
DISTRIBUTING PHONORECORDS
(Phonorecords III)

Docket No. 16-CRB-0003-PR (2018-2022)
(Remand)

ADDITIONAL MATERIALS REBUTTAL SUBMISSION OF COPYRIGHT OWNERS

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TAB A

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**COPYRIGHT OWNERS' REBUTTAL BRIEF
CONCERNING THE ADDITIONAL MATERIALS ORDERS**

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Glossary of Abbreviations

Abbreviation	Document
Additional Materials Orders or AMO	Dec. 9 Order and Jan. 6 Order together
CO AMO Submission	Copyright Owners' Additional Materials Submission, eCRB Docket No. 26061, Jan. 24, 2022
CO AMO Br.	CO AMO Submission, Copyright Owners' Brief in Response to the Additional Materials Orders, eCRB Docket No. 26061, Jan. 24, 2022
CO Br.	Copyright Owners' Initial Remand Submission, eCRB Docket No. 23854, Apr. 1, 2021
CO Reply Br.	Reply Remand Submission of Copyright Owners, eCRB Docket No. 25425, July 2, 2021
Dec. 9 Order	Notice and Sua Sponte Order Directing the Parties to Provide Additional Materials, eCRB Docket No. 25965, Dec. 9, 2021
Eisenach AWDT	CO AMO Submission, Additional Written Direct Testimony of Jeffrey A. Eisenach, PhD eCRB Docket No. 26061, Jan. 24, 2022
Eisenach RWRT	CO Reply Br., Remand Written Rebuttal Testimony of Jeffrey A. Eisenach, PhD, eCRB Docket No. 25425, July 2, 2021
FD	Final Determination, eCRB Docket No. 3473, Nov. 5, 2018
Initial Determination	Initial Determination, eCRB Docket No. 2288, Mar. 19, 2018
Jan. 6 Order	Order Granting in Part and Denying in Part Copyright Owners' Motion for Reconsideration or, in the Alternative, Clarification, eCRB Docket No. 26007, Jan. 6, 2022
Katz WSRT	Katz Written Supplemental Remand Testimony, eCRB Docket No. 26056, Jan. 24, 2022
Leonard SSWRT	Second Supplemental Written Remand Testimony of Dr. Gregory K. Leonard, eCRB Docket No. 26047, Jan. 24, 2022
Marx WSSRT	Written Second Supplemental Remand Testimony of Leslie M. Marx, eCRB Docket No. 26051, Jan. 24, 2022

Remand Order	Order Regarding Proceedings on Remand, eCRB Docket No. 23390, Dec. 15, 2020
Services WP Br.	Joint Supplemental Brief Addressing Judges' Working Proposal, eCRB Docket No. 26053, Jan. 24, 2022
Watt AWDT	CO AMO Submission, Additional Written Direct Testimony of Richard Watt eCRB Docket No. 26061, Jan. 24, 2022
Watt RWRT	Remand Written Rebuttal Testimony of Richard Watt (PhD), eCRB Docket No. 25425, July 2, 2021
Working Proposal or WP	Various contemplated rate structures and rates referenced in the Dec. 9 Order and Jan. 6 Order

Copyright Owners (“COs”) respectfully submit this rebuttal brief to respond to the Services’ Joint Supplemental Brief Addressing Judges’ Working Proposal, eCRB Docket No. 26053, Jan. 24, 2022 (“Services WP Br.”), which was submitted in response to the Judges’ AMOs and WP referenced therein.¹

INTRODUCTION

Each participant has objected to the WP, but for very different reasons. COs object because the WP disregards *Johnson*’s affirmed findings and its mandate, improperly reopening issues not remanded. Nevertheless, the WP is the same formula as used in the FD and once the formula’s ratio is corrected to 2.5:1, as required under the Judges’ own discussion of *Johnson* in the AMOs, the WP delivers a higher revenue rate than the FD. COs agree with the AMOs’ finding that the ■% combined royalties percentage used in the FD is too low, and agree that the royalty rates should be higher than those in the FD, but submit that this issue is beyond the scope of this remand. It is instead an issue for *Phonorecords IV*.

The Services also object to the WP, likely because they too understand that the 3.82:1 ratio is foreclosed by *Johnson*, and that once the ratio is corrected the WP raises the revenue rate above the FD. The Services’ objection to the WP is not founded in the FD, or in *Johnson*, but is simply an attempt to lower royalty rates.

As documented below, the Services’ submission is replete with contradictory arguments and statements that are contrary to prior sworn testimony. The Services’ approach disregards the questions raised in the AMOs (as well as the analysis in the WP, the FD and *Johnson*), instead

¹ Except where otherwise defined herein, capitalized terms are as defined in the CO AMO Br. For convenience, these definitions/abbreviations are collected in the Glossary of Abbreviations preceding this brief.

advancing meritless and previously rejected arguments, seeking to will lower rates into existence through repetition.

For example, the Judges posed the question of how the alleged label complementary oligopoly power “should or should not” affect the analysis. In response, not a single one of the three Service witnesses provides any analysis. Not only that, but the Services have failed to provide any empirical evidence, any economic proof or even any economic analysis showing that there is a bona fide economic problem resulting from the major labels’ alleged market power that justifies lowering rates, let alone showing what those effects are or what the rate adjustments should be. COs have consistently pointed out that, outside of pointing to the *Web IV* determination (in which COs were not participants), the Services have never provided any evidence in support of the major labels’ alleged complementary oligopoly power, and through no less than *four* additional rounds of submissions on this remand, the Services have offered nothing to cure this failure.²

Seizing on a comment in the AMOs, the Services coin a new term, “survival rate,” and then alternately reject and embrace it. They first admit that the “survival rate” does not actually govern royalty payments (including that it does not fit market realities, and that the major labels have no idea what such rate would be), and then reverse course, advancing an unsound and unproved “survival rate” to press for lower rates. This “survival rate” fiction is directed at a problem that

² The Services meekly suggest the Judges import the 12% steering adjustment from *Web IV*, yet know full well the Judges already rejected such importation. See *Determination of Royalty Rates and Terms for Transmission of Sound Recordings by Satellite Radio and “Preexisting” Subscription Services*, 83 Fed. Reg. 65210, 65237 (Dec. 19, 2018) (“SDARS III”) (“The Judges cannot simply import the 12% steering adjustment from *Web IV* into the satellite market; that 12% figure was derived from highly specific evidence presented in *Web IV*.”); FD at 54 (“The Judges are reluctant to simply import the 12% rate reduction from *Web IV* into other determinations... The specific 12% figure was based on record evidence derived from steering experiments and agreements analyzed in *Web IV*.”). Further, as shown in the CO Reply Br. at 54, the FD already imposed a far greater downward reduction in the FD on a theory of avoiding “importing complementary oligopoly profits into the musical works rate through a TCC percentage.”

does not exist. The WP uses the formula in the FD that *Johnson* affirmed. The WP takes a combined royalty rate and applies a ratio to split that rate between sound recording and musical works royalties (albeit, mistakenly suggesting the wrong ratio). This methodology is sound and was affirmed in *Johnson*. While the WP implies that the major labels “allow” the Services to retain a portion of revenues, this gloss does not change the methodology, and the WP does not assume that bargaining does not occur or that the labels’ marketplace deals are not effectively competitive or leave the Services with inadequate returns.

In an attempt to minimize royalty rates, the Services first propose low combined royalty rates, repeatedly contradicting themselves to contrive low numbers. Then, ignoring the FD, *Johnson*, and the Judges explicit statement that they “have not indicated a willingness to revisit the Shapley Value proportions” (Jan. 6 Order at 6), they propose their own ratios that fall far outside even the range of reasonable ratios posited in the FD, let alone the chosen and affirmed ratio of 2.5:1. The Services’ submission is not a serious effort to address the questions raised by the AMOs and the WP. Instead, it is an evasion that tacitly admits that the answers those questions point to higher rates and a continuation of the rate structure in the FD.

ARGUMENT

I. THE SERVICES’ OBJECTIONS TO THE WORKING PROPOSAL CONFLICT WITH THEIR OTHER ATTEMPTS TO REDUCE ROYALTY RATES

The Services’ submissions all reject the WP. (*See, e.g.*, Marx WSSRT ¶ 21 (“because the Judges’ rate-setting algorithm embeds an assumption of a one-to-one see-saw, it is contrary to the goals of the 801(b)(1) factors and indeed the entire notion of CRB oversight of royalty rates.”); Katz WSRT at ¶ 3 (“the Working Proposal is built on the assumption of a 100-percent “see-saw effect” between musical works royalties and sound recording royalties. This assumption has no basis in sound economic theory and no support in the factual record.”); Leonard SSWRT at 2 (“The

Working Proposal Assumes a One-For-One See-Saw, Which Has No Sound Theoretical Basis and Is Inconsistent with Real-World Outcomes”).)

Two contradictory positions are at the center of this rejection. First, the Services frame their rejection of the WP around their dispute of a “see-saw” effect. Second, the Services allude to an unproven theory that the major labels will use “complementary oligopoly power” to extract all of the surplus in negotiations and leave the Services with less than their contrived “survival rate.” However, *these two positions are in direct conflict with each other* and, as shown below, Dr. Katz has rejected the conception both that the major labels either know what any of the Services’ supposed “survival rates” might be or that the major labels extract all of the surplus. As Professor Watt explained in dismantling the Services’ straw man see-saw argument, for the Services to argue that there is a lesser see-saw effect is for them to argue that there is no complementary oligopoly problem. (*See* Watt RWRT ¶¶ 24-26.) In explaining how the Board’s reasoning on bargaining theory in the FD was correct, Professor Watt explains that the strong see-saw effect seen in his model was based on Professor Marx’s assumptions that the labels were extracting all of the surplus in negotiations. (*Id.* at ¶¶ 6(iv), 8.) If instead the labels extract less than all of the surplus in negotiations with the Services—as Dr. Katz admits—then by definition the Services extract more of the surplus. The fact that there will then be a lesser see-saw effect is both true and also not the salient point.³ The salient point is that the Services are extracting surplus in negotiations and the market is indeed effectively competitive. Putting a thumb on the scale for

³ Of course, the entire see-saw argument is itself a distraction. (*See, e.g.*, CO Reply Br. Point II.B.) The evidence on remand showed [REDACTED] (CO Reply Br. at 39-41, citing evidence), and the Services conceded that they were not disrupted or even impacted in any way by virtue of either the FD’s musical works royalty increase or their label rates (whether or not they decreased). (*Id.* at 34-39.)

the Services by adjusting rates downwards for alleged ineffective competition would be unreasonable.

COs address the Services' assertions concerning their "survival rate" further below.

II. THE SERVICES' DISREGARD OF THE 2.5:1 RATIO VIOLATES *JOHNSON* AND IS METHODOLOGICALLY UNSOUND

The Services' submission is foundationally flawed because it does not employ the 2.5:1 Shapley ratio that the Board used to determine the revenue rates in the FD, which *Johnson* affirmed and which the Judges have acknowledged they cannot now alter. As COs showed in their CO AMO Submission, the WP mistakenly substitutes a 3.82:1 ratio (derived from the FD's adjusted TCC rate) in place of the 2.5:1 ratio determined appropriate in the FD. (*See e.g.*, CO AMO Submission; CO AMO Br. at 2, 25-26; Watt AWDT ¶¶ 3(ii), 15-27, 36-40; Additional Written Direct Testimony of Jeffrey Eisenach ¶¶ 10-22 ("Eisenach AWDT").)

Johnson affirmed this 2.5:1 ratio as representing the "type of line-drawing and reasoned weighing of the evidence [that] falls squarely within the Board's wheelhouse as an expert administrative agency." *Johnson v. Copyright Royalty Board*, 969 F.3d 363, 385-86 (D.C. Cir. 2020).⁴ (*See also* CO AMO Br. at 6-7, 25-26.) The AMOs acknowledged that *Johnson* forecloses altering this Shapley-derived ratio. (*See id.* at 6-7 (discussing Jan. 6 Order at 9 n.13).)

While Prof. Marx acknowledges that the Board used the 2.5:1 ratio to derive its 15.1% revenue rate, her analysis then ignores that finding. (*See* Marx WSSRT ¶ 4 n.6 ("The 15.1% was derived by the Majority by multiplying the all-in royalty rate of ■% derived from one Marx

⁴ Unless stated otherwise, all emphasis herein is added and all quotation marks and citations are omitted.

Shapley model by the 2.5:1 ratio used in the Gans Shapley-inspired model.”.)⁵ Despite their admission, nowhere do the Services explain any basis allowing them to use other ratios to generate the revenue rate. As discussed in detail in the CO AMO Submission, that 3.82:1 ratio is derived from the 15.1% revenue rate. It cannot be used as an input to create a revenue rate from which it came. (See Watt AWDT ¶¶ 3(ii), 22-27, 37; Eisenach AWDT ¶¶ 10, 16-21.)

III. THE SERVICES’ “SURVIVAL RATE” ARGUMENT MISREADS THE JUDGES’ ORDERS, IS CONTRADICTED BY THE RECORD, AND IGNORES THE ECONOMIC REALTIES AND THE MARKETPLACE

A. The Services’ “survival rate” argument misreads the AMOs

The Services attribute to the Board the concept of a “survival” rate:

The Working Proposal flows from the Judges’ finding that the major record labels “are unregulated complementary oligopolists” that “do not retain so much of the Services’ revenue that they deprive the interactive service sector of revenues sufficient to allow them to survive.” Working off that premise, the Judges’ new rate-setting formula leaves the Services with what the December 9 Order describes as their “survival” rate

(Services WP Br. at 1.) The Dec. 9 Order does not mention a “survival rate” or define what it might mean. Nor is the Services’ conception of a “survival rate” a suitable take-away from the AMOs. Rather, the Dec. 9 Order is clarified by the Jan. 6 Order which reiterates that the major labels do *not* retain so much that they deprive the services of revenues sufficient to survive. (Jan. 6 Order at 6.) However, agreement that the major labels do not deprive the Services of revenues sufficient to survive is not a finding that the major labels take every penny up to that point of survival.⁶ It is simply a finding that the record companies do not threaten the existence of the

⁵ This is underscored in Dr. Marx’s Figure 2, which takes the exact same all-in royalty figure the FD employed, █%, and yet arrives at a *different* revenue rate than the FD reached, █% rather than 15.1%. (Marx WSSRT ¶ 11 Figure 2.) The sole reason for this different revenue rate is that the Services employ the wrong ratio.

⁶ Indeed, as discussed below, the Services’ submission admits that there is no evidence that the labels even have any comprehension of what that any Service’s “survival” rate might be.

streaming industry.⁷ On the contrary, the Jan. 6 Order highlights the FD’s finding that the major labels have “powerful economic motivation” to “pursue deals with the Services that ensure the continued survival *and growth* of the music streaming industry.” (Jan. 6 Order at 6 (quoting FD at 74) (emphasis in Jan. 6 Order).)

The emphasis added by the Jan. 6 Order was to the words “*and growth*.” This is consistent with the FD’s finding that the major label deals provide for not merely survival, but facilitate the Services’ growth, which the record has shown occurred. Indeed, there is no evidence that the major labels are even capable of determining what amount is *only just enough* to allow the Services to “survive” and Dr. Katz admitted that the contrary is true. Their admission accords with the FD’s explicit rejection of just such a “survival rate” concept, noting that, “the Judges find that it would be highly coincidental (and is unsupported by any evidence) that the present rate levels establish in essence a maximum level of losses the Services collectively can sustain, such that a reduction in losses is unnecessary but an increase in losses will lead to their demise.” (FD at 57 n.107.)

B. The record contradicts the Services’ “survival rate” framing

The record does not support the idea that any of the Services pay royalties equal to a “survival rate” below which they would not continue to operate. There is no such evidence in the record, as both the FD and the Dissent already concluded. (FD at 88 (observing that the “limit to [the Services’] losses . . . beyond which services will be unable to attract capital and survive” is

⁷ This finding is also a response to Service arguments that the “uncapped” TCC rate prong threatened disruption of the streaming industry. *Johnson*’s remand on rate structure was based on Service arguments that they were deprived of the opportunity to provide evidence of disruptive impact of expanding the “uncapped” TCC rate prong. (See CO Reply Br. at 35-36; *Johnson*, 969 F.3d at 383.) The Services wholly abandoned that appeal argument in this remand proceeding, admitting they did not suffer any material impact from the *Phonorecords III* rates or rate structure, let alone disruption. (*Id.* at 34-39 (citing the record).) The Jan 6 Order places that admission in its economic context: the streaming industry is not facing disruption from major record companies.

“imprecise and unknown,” FD, Dissenting Opinion at 148 (same).) The Services’ witnesses were asked at the hearing what rates would threaten their viability, and they testified to never even attempting [REDACTED] of their streaming operations. (See Tr. 2153:12-22 (McCarthy); Tr. 1570:14-1571:16 (Mirchandani); Tr. 222:9-21 (Levine); 5195:10-5197:11 (Leonard).)

Indeed, for years the Services have all thrived, not merely survived, while paying combined effective royalty rates [REDACTED] [REDACTED] (See Eisenach RWRT ¶ 13 & Figure 1.) In 2017, for example, the Services’ combined effective royalty rates [REDACTED]. (*Id.* ¶¶ 13, 19, 25, 30, 35 & Figures 1, 2, 4-5 and 8.)⁸ Those Services are all still operating and even growing. Even Spotify has stockpiled billions of dollars in cash, including amassing \$1.8 billion in cash *in 2021 alone*. This is [REDACTED] *Spotify’s aggregate industrywide U.S. compulsory mechanical royalty pools from inception of U.S. activities in 2011 to this remand*, stockpiled in cash just last year alone. (*Id.* ¶¶ 49, 58-62; Eisenach AWRT at Sec. IV(A)(1).) The idea that the Services pay “survival rates” is simply not consistent with the marketplace evidence.

C. The “survival rate” framing ignores the Services’ information asymmetry and the revenues they derive as a result of their revenue diminution and mismeasurement

The Services admit that the major labels lack information to even identify “survival rates,” let alone extract all surplus up to such rates. Dr. Katz states this explicitly, explaining that the WP

⁸ As Dr. Eisenach explained, [REDACTED] (Eisenach RWRT ¶ 19 n.32.) [REDACTED] (*Id.* ¶ 19.) [REDACTED] (*Id.* ¶¶ 25-26.)

“presents a highly unrealistic view of the licensing negotiations between the Majors and the Services,” one that “implicitly assumes that: (a) there is a single survival rate; [and] (b) that rate is perfectly known to all of the Majors” (Katz WSRT ¶ 17.)⁹ Dr. Katz says that this (alleged) assumption is incorrect because “the Majors have imperfect information about the Services’ varying financial conditions and objectives.” (*Id.* ¶ 19 (suggesting the major labels can, at best, make rough guesses as to whether a higher royalty demand would “more likely . . . push a service below its survival revenue rate”).)¹⁰ While Dr. Katz tries to reframe this information asymmetry as making it uncertain if a service would be “pushed below” its “survival rate,” that ignores that the asymmetry runs in favor of the Services. As Dr. Katz admitted in his deposition, [REDACTED]

[REDACTED]

[REDACTED]. (See Watt RWRT ¶ 39 (quoting Katz deposition transcript).). Far from pointing to label rates being too high, this informational asymmetry points to a lack of effective competition *to the Services’ benefit* and predicts that label royalty rates will be *lower* than they would be in an effectively competitive market. See *Web V* Initial Determination at 207, n.287 (explaining that “[o]ne of the necessary conditions for a market to be effective is the absence of asymmetric information.”)

Revenue diminution and mismeasurement are a large part of this informational asymmetry, and further highlight the incompatibility of the Services’ “survival” revenue rate approach with

⁹ The Services also discuss this information asymmetry in arguing that the major labels did not have information to accurately predict effective mechanical royalty rates. (See Services WP Br. at 12 n.7.)

¹⁰ Importantly, Dr. Katz acknowledges that this information asymmetry extends to the *Judges* as well, such that the Judges cannot know what the Services’ supposed “survival” rates actually are nor whether any major label has actually identified those “survival” rates. (Katz WSRT ¶ 19 (“[T]he Judges have highly imperfect information about the Majors’ beliefs regarding the financial conditions and objectives of the Services.”).)

the marketplace.¹¹ Under both *Phonorecords II* and the FD, revenues for royalty purposes do not capture all of the value realized by a Service by virtue of the licensed offering. As a result, revenue rate prongs alone do not reliably capture and deliver royalties commensurate with the intended share of gains, which as noted in footnote 11 below, Drs. Marx and Leonard argued necessitated backstops properly calibrated to protect against mismeasurement and displacement.

An example of this involves the service revenue definition for bundled offerings. *See* 37 C.F.R. § 385.11 (2014) (“Service revenue” definition); 37 C.F.R. § 385.2 (2019) (“Service Provider Revenue” definition). Under the *Phonorecords II* definition, a service could report zero revenues from bundled offerings with millions of users, [REDACTED]. (*See e.g.*, CO Br. at 84.) [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] (*See id.* at 85-88 (citing the record).)

Dr. Katz argues that a single “survival rate” is “highly unrealistic” because, among other things, “the Services are heterogenous in terms of a range of factors, including their scale, revenue models, and relationships to complementary products offered by the parent firms.” (Katz WSRT ¶¶ 17-18.) Dr. Marx admits it is more difficult to [REDACTED]

¹¹ As COs previously showed and the FD found, the Services engage in various revenue diminution practices, none of which the Services challenged on appeal. *Johnson* noted an example of the Services’ revenue diminution in the form of family and student discount plans. (*See* CO AMO Br. at 9-14, citing the record.) Indeed, Drs. Marx and Leonard admitted that, with a revenue-based system, [REDACTED]. (Tr. 5262:1-5263:1 (Leonard); Tr. 1902:24-1903:1, 1964:25-1966:12 (Marx).)

[REDACTED], which is a service that has complementary products. (*See* Marx WSSRT ¶ 15.) However, Professor Marx gets wrong that Spotify is still a pure-play service. Spotify’s significant investment in podcasting takes it out of the pure-play category, using Professor Marx’s own litmus test of a material portion of revenues not being in the music revenue base. (*See* Tr. 1965:10-24 (Marx).)

Moreover, revenue measurement problems also apply to pure-play services. Even in the past when Spotify could be considered a pure play, [REDACTED] [REDACTED] (Tr. 2081:13-2084:15 (McCarthy) [REDACTED]); Eisenach RWRT ¶ 50 & CO Rem. Ex. I at 1.00022 (statements by McCarthy on an earnings call that Spotify’s accounting profits are merely “a by-product of the pace we choose to invest in new features and functionality to drive growth”).)

IV. THE SERVICES’ PROPOSED WORKING PROPOSAL INPUTS AND ALTERATIONS ARE INAPPROPRIATE AND CONTRARY TO THE RECORD

The Services’ experts propose a variety of inputs and adjustments to the Working Proposal, which they then interpret to point to lower royalty rates. These include: (i) combined royalty rate inputs; (ii) alternative ratios; and (iii) ungrounded “adjustments.” These inputs and adjustments are addressed in detail in the accompanying Additional Written Rebuttal Testimony of Jeffrey Eisenach (the “Eisenach AWRT”). Copyright Owners do not repeat or summarize Dr. Eisenach’s detailed arguments in this brief, but respectfully refer the Judges to the expert analysis present by Dr. Eisenach. Suffice to say, as shown by Dr. Eisenach, the Services misrepresent [REDACTED] [REDACTED], improperly focus on their headline rates rather than their effective rates [REDACTED] [REDACTED], and their presumption that

the labels would have assumed that the mechanical rates would have remained unchanged by *Phonorecords III* is not only unfounded but is also illogical.

Although the combined royalty rates that the Services propose are unreasonably low, their proposed combined rates still derive a revenue rate higher than 15.1% using the 2.5:1 Shapley ratio that was adopted in the FD, affirmed by *Johnson*, and ratified in the AMOs (albeit with mistaken reference to an inapplicable 3.82:1 ratio).¹² The Services then attempt to replace the adopted and affirmed ratio with alternative ratios (Pandora’s non-interactive royalty-based ratio, a CD and PDD rate-based ratio) above even the 3.82:1 and the range of reasonable ratios considered in the FD.¹³ These alternative ratios (including one from the non-interactive space that involves, among other things, a different right under copyright, different functionality, and different licensors) are just as inappropriate and foreclosed as the 3.82:1 ratio. (*See* Eisenach AWRT Sec. III.)¹⁴ The

¹² In support of their arguments, the Services try to submit new evidence through Dr. Marx’s report, in the form of hearsay statements by Spotify personnel from interviews she purportedly took last month. (Marx WSSRT ¶ 17 n.22 & n.23.) While these hearsay statements are not persuasive on any material issue, and do not change the analysis or conclusions, they are still objectionable and COs respectfully submit that they should be disregarded. The AMOs do not allow for new fact witness testimony (*see* Dec. 9 Order at 5); more generally, the rules do not permit a participant to introduce unsworn fact witness testimony by embedding it in its expert’s report. *C.f.* 37 C.F.R. § 303.6(d). The Services also improperly attempt to introduce new evidence regarding [REDACTED] (see Marx WSSRT ¶ 17 n.23; Services WP Br. at 12) and additional information regarding [REDACTED]. (*See* Marx WSSRT ¶ 17 n.22) This hearsay and related testimony in Professor Marx’s report should be disregarded.

¹³ This is particularly discordant for Professor Marx, since her own testimony at the hearing proposed a ratio far below the ones she now advances. (*See* FD at 68.)

¹⁴ The Services’ efforts to import the ratio from the non-interactive space (involving, among other things, a different copyright, functionality, and licensors) further contradicts the FD and *Johnson* by jettisoning the ratio that *Johnson* affirmed and suggesting substitution of ratios falling outside the range the Board considered when setting rates (*see* FD at 72-75). It also ignores the Judges’ findings that they cannot change that ratio and are not “willing[] to revisit the Shapley Value proportions” (*see* Jan. 6 Order at 6, 9 n.13). ¹⁵ *See* FD at 59 (finding Subpart A was “at best a guideline as to the rates below which the subpart B and C rates cannot fall” because of differences in access value, economic risk to licensors, and identity of licensees between the benchmark and target markets); Dissenting Opinion at 110-115; *Johnson*, 969 F.3d at 386 (holding that “the Board reasonably treated the Part A settlement rates as, ‘at best,’ a floor below which the disputed categories rates should not fall.”)

Services’ half-hearted invocation of the “Subpart A” ratio ignores the dispositive fact that it was already rejected by the FD, the Dissent and *Johnson*.¹⁵ (CO Reply Br. at 9-10.) The Services’ reference to the *Phonorecords IV* Subpart B settlement does not change the reasons why the COs settlement with the labels was rejected and it is also not even part of the record in this proceeding.¹⁶

Finally, the “adjustments” that the Services propose are unfounded “Hail Mary” attempts to lower rates. The Services are aware that the steering adjustment from *Web IV* has no supporting evidence in the record, and has been rejected by the Judges for use outside of the *Web* proceedings. (*See supra*, n.2.) The proposed adjustment also ignores that the FD already imposed a far larger reduction to the TCC rate in connection with effective competition concerns. (CO Reply Br. 54.) Finally, Professor Marx’s fabricated “imbalance” concept is offered without a single citation to economic precedent and without any theoretical or empirical support.

As Dr. Eisenach explains in detail, none of these proposed inputs or adjustment are economically sound nor supported by the evidence. (Eisenach AWRT ¶¶ Secs. II(C), III.)

V. THE SERVICES’ 801(B) ANALYSIS IS WRONG ON THE LAW AND THE FACTS

The Services argue that the WP violates the 801(b)(1) factors because it supposedly “by design . . . would leave the Services (at most) with only whatever the record companies think is

¹⁵ *See* FD at 59 (finding Subpart A was “at best a guideline as to the rates below which the subpart B and C rates cannot fall” because of differences in access value, economic risk to licensors, and identity of licensees between the benchmark and target markets); Dissenting Opinion at 110-115; *Johnson*, 969 F.3d at 386 (holding that “the Board reasonably treated the Part A settlement rates as, ‘at best,’ a floor below which the disputed categories rates should not fall.”)

¹⁶ Professor Marx’s footnote on the settlement, which is simply an abbreviated version of the attorney argument in the Services’ joint brief, does not address the reasons it was rejected. (Marx SSWRT ¶ 35 n.46; Services WP Br. at 26-7.) The Services also misstate the FD to imply that it endorsed Dr. Leonard’s ratio, when the Board was just summarizing his analysis without accepting his ratios. (FD at 61.) Moreover, while the Subpart A argument was rejected by the Majority, the Dissent and the Circuit and cannot be reconsidered here, it is not even correct that the ratio derived from Subpart A would be as the Services argue, as the record evidence showed tracks with a much lower 49 cent price point, and using that retail price would yield a ratio of almost exactly 2.5:1. (*See* FD at 58.)

sufficient to allow them to survive” (Services WP Br. at 16-19.) Beyond contradicting their own arguments that the major labels neither know nor only leave the Services with “survival rates,” the Services’ argument also ignores the FD and *Johnson*.

Factor A was found in the FD to support higher royalty rates, a finding upheld by *Johnson*, 969 F.3d at 387-88. It is not remanded and is not open to reargument on remand. The Services do not even attempt to reconcile this holding with their arguments for *Phonorecords II* or lower rates.¹⁷

With respect to Factors B and C, as explained in the CO AMO Submission, the Majority, the Dissent, and even the Services’ experts agreed that Factors B and C are addressed by Shapley analysis. (See CO AMO Br. at 29-30 & n.33, citing the record.) The FD’s Shapley-derived rates fully satisfy these factors, and *Johnson* upheld the Board’s rate derivation determination in the FD.

The Services ignore these holdings, and instead offer a Factors B and C analysis focused only on their contrived “survival rate.” This argument is offered even though the Services repeatedly admit and argue that the major labels do not know what the Services’ “survival rates” might be nor are they what the Services actually pay in the real world. (See, e.g., Katz WSRT ¶¶ 17-19.) Thus, the Services’ argument amounts to no more than claiming that a situation that they admit does not actually exist (“survival rates”) might hypothetically lead to an undetermined and unproven unfairness.

The Services argue, without any evidence, that the major labels assumed musical works royalties would not exceed the *Phonorecords II* rate levels. Then, having already admitted that

¹⁷ The Services’ only contention as to Factor A is Dr. Katz’s empty theorizing that *if* the Services ended up in “poorer financial conditions going forward” it would not “maximize availability.” (Katz WSRT ¶ 24.) Dr. Katz cites no evidence for this claim, which is mentioned in a single sentence in his report and which contradicts the Board’s affirmed finding that maximizing the availability of musical works requires a rate increase.

the major labels do not know what their “survival rates” might be and that the major labels do not actually extract all of the available surplus up to this unidentified and unknown level, they inconsistently argue that the major labels took all of the remaining surplus, leaving the Services with only just enough to survive. Based entirely on this internally inconsistent and unsupported argument, the Services contend that the Board cannot increase mechanical rates above the *Phonorecords II* levels without supposedly imperiling the Services’ survival. (See e.g., Services WP Br. at 6-7, 22; Marx WSSRT ¶¶ 15, 21.) The Services’ argument would *preclude* the Board from engaging in its statutorily mandated task of determining reasonable rates for musical works owners under the 801(b) factors.

Moreover, the evidence demonstrates that the Services *have* been afforded the opportunity to earn a fair income, as evidenced by the gains they have actually received,¹⁸ and far from the spectre of “runaway rates” they offered the Circuit, the Services’ effective sound recording and combined royalty rates [REDACTED] (see CO Reply Br. at 30-31 (citing the record).)

With respect to Factor D, it bears emphasis that the Services abandoned their appeal argument of disruption, admitting that they would not be offering disruption evidence on remand (see CO Br. at 36-38 (citing the record)). Nonetheless, as with Factors B and C, the Services seek to conjure an argument from their own flawed “survival rate” concept. They claim that *if* rates are set so high that the Services cannot “survive,” then they will be disrupted “by definition.” (See Services WP Br. at 19, 23-24.) But given their admission that “survival rates” are not what is

¹⁸ (See e.g., Tr. 2085:1-15 (McCarthy) ([REDACTED]); Eisenach RWRT ¶¶ 45-55.)

actually paid in the marketplace, this warning remains purely hypothetical and unsupported by any record evidence.

The Services also hypothesize that *were they* to experience effective rates higher than the headline revenue rate, or *were they* to be not sufficiently profitable, that could constitute disruption.¹⁹ (See Services WP Br. at 19, 31.) This theoretical argument is not disruption. As stated in the FD, adjustment of a rate on the basis of Factor D requires actual evidence that the rate would:

directly produce [] an adverse impact that is substantial, immediate and irreversible in the short-run because there is insufficient time for either [party] to adequately adapt to the changed circumstance produced by the rate change and, as a consequence, such adverse impacts threaten the viability of the music delivery service currently offered to consumers under this license.

(FD at 87.)

Mere increases in royalty payments are not disruptive as a matter of law. *See SDARS I*, 73 Fed. Reg. at 4097. And in previously analyzing disruption, the Board already rejected the Services' argument that the Board must somehow set rates to ensure the Services' accounting profitability, recognizing that the Services' year-over-year losses were incurred in their "Schumpeterian competition for the market," and that there was no evidence suggesting that their

¹⁹ This attempt to change the disruption standard is based on a mischaracterization of the determination in *SDARS I*. (See Services WP Br. at 19.) *SDARS I* did not apply a different standard for disruption, but set forth the same standard quoted in the FD, and explained how that standard was met in that case. *See* 73 Fed. Reg. 4080, 4097 (Jan. 24, 2008); *see also* FD at 87. In particular, *SDARS I* held that at that time (in 2008), the SDARS services did not yet have scale to generate free cash flow, and under higher rates would not be able to pay a critical cost that "distinguish[es] them from other digital distributors of music," namely "their expenditure for satellite technology." *Id.* at 4096-97. The Judges noted that those satellite costs "[c]learly... cannot be postponed without a serious threat of disruption to the service." *Id.* The Judges further noted that even SoundExchange acknowledged the threat of disruption and offered lower initial rates. *Id.* at 4097. In response to this, the Judges phased in the rate over the five-year period. *Id.* at 4098. The *SDARS I* context is entirely different from the current interactive streaming market, where even Spotify is generating billions in free cash flow every year, where no service has necessary infrastructure costs like satellite technology, and where the market is already at a huge scale. The *SDARS I* analysis does not support a different disruption standard, or a disruption adjustment here, and the Services offer no argument that it does.

“current level of short-term losses is the maximum that the Services can absorb” and it was “not the Judges’ role to protect the current players in the industry.” (*See* FD at 57 n.107, 74, 74 n.137, 87-88, 88 n.160.)²⁰

VI. THE SERVICES PROVIDE NO SUPPORT FOR ADJUSTING THE FINAL DETERMINATION’S RATE STRUCTURE

A. The Services’ rate structure arguments provide no basis for eliminating or “capping” the TCC prong

The Services’ rate structure arguments are internally inconsistent and unsupported by record evidence. Although proposing TCC prongs for all offerings, they accept the WP’s consideration of eliminating the TCC prong, to “prevent the musical works royalty rates from arbitrarily increasing . . . every time the sound recording rightsholders . . . extract higher royalty rates.” (Services WP Br. at 30.) But as the Services elsewhere argue, the label rates not only [REDACTED], but they have already been set for this rate period. (*See* Marx WSSRT ¶ 22 (“sound recording rates for the Phonorecords III period have already been negotiated and have largely already been paid”); Leonard SSWRT ¶ 13 (“The Phonorecords III rate period is almost over and the sound recording royalties have largely been paid (or the rates have been set by contract)”). For the same reason, retroactively “capping” the TCC prong is unnecessary because the “arbitrary increases” (or “runaway rates”) conclusively never happened and cannot happen in this rate period. (*See* CO AMO Br. at 15-17.)²¹

²⁰ The Services’ arguments for “phasing in” new rates are also unavailing. They argue that phasing-in is helpful to “mitigate the risk of short-term market disruption.” (Services WP Br. at 6 n.2.) However, again, they admit that the determination in this remand proceeding will be effectively retrospective. (*See* Leonard SSWRT ¶ 6. n 4; *see also id.* ¶ 7; Katz WSRT ¶ 24.) Retrospective rates are not phased in over time, and so “phasing in” such rates serves no purpose except to work a decrease in the average royalty rate across the rate period.

²¹ The Services’ 801(b)(1) argument with respect to rate structure makes the same reference to possible “arbitrary increases” to sound recording rates that the Services admit cannot happen. (*See* Services WP Br. at 30.) And as noted, the Services offered no showing that the true (“uncapped”) TCC caused disruption or even any negative financial impact. The Services’ claim that “eliminating the TCC prong would better comport with the requirements of Section

The Services do not reconcile their argument that the TCC should be eliminated with the fact that all of them are proposing to implement a TCC prong and their own experts insisted at the hearing that the TCC prong was a necessary backstop to a percent of revenue rate structure to protect against revenue diminution and mismeasurement (along with per-subscriber rates properly correlated to the percent of revenue and the standalone price). (See CO AMO Br. at 5-6, citing the record).) Contradicting these positions (and ignoring that the mechanical floor prong was not considered protection against revenue diminution, but was rather protection against public performance royalties eliminating mechanical income through the all-in rate structure (*id.* at 18-19, citing the record)), the Services now claim it could be reasonable to eliminate the TCC prong altogether and assert that the mechanical floor adequately protects against revenue diminution. (See Services WP Br. at 30 n.22 (*citing* Marx WSSRT ¶ 38).) The many inconsistencies in the Services’ positions is exemplified in the very next footnote when they argue the Judges should “remove the TCC prong and the mechanical floors,” leaving only a “single percentage-of-revenue rate” (*id.* 31 n.23), a position that contradicts the testimony of the Services’ experts at trial and the Services’ position throughout this proceeding. (See *e.g.*, CO AMO Br. at 5-6, 12 n.12, 19-20 (citing the record).).²²

801(b)(1)” (See Services WP Br. at 30) is particularly baffling because the Services’ rate proposals, including their rate proposal on remand, *include* a TCC (and one that is “uncapped” for most offering types). (See Joint Written Direct Remand Submission, Services’ Joint Rate Proposal at 2-3, eCRB Docket No. 23849, Apr. 1, 2021.)

²² The Services also largely ignore that many offering types had no mechanical floor under the *Phonorecords II* structure. (See CO AMO Br. at 18.) Dr. Marx contends that

(Marx WSSRT ¶ 38.)

In the end, the Services cannot resolve their contradictory positions, nor explain how their positions are consistent with the FD's findings regarding revenue diminution, or the findings and their own prior insistence that percent of revenue structure required adequate alternative rate prongs. (*See* CO AMO Br. at 12 n.12 (citing the record).)

B. The Services do not address proper rate levels of alternative prongs if the FD rates were to change

The Services also fail to address what the levels of any alternative rate prongs should be in the event that a new rate structure or rates were to be adopted. Prof. Marx states that any “cap” on the TCC prong must be “set correctly” but goes no further because she knows it would require setting a higher cap calibrated to the higher percent of revenue. (*See* Marx WSSRT ¶ 39.) As Copyright Owners previously showed, while the Services’ experts (including Prof. Marx) acknowledged that the alternative rate prongs’ levels must be properly calibrated, no Service expert could explain how the per-subscriber minimum rate that “capped” the TCC under *Phonorecords II* had been set (*see* CO AMO Br. at 22-23), and the “cap” was so low that it effectively eliminated the protection of the TCC prong (*see id.* at 24 & 24 n.25). The evidence and hearing testimony showed that per-subscriber caps in the rate structure must be set at a level that properly correlates to the percent of revenue of the stated subscription price to provide the intended protection against revenue mismeasurement. (*See id.* at 23-24.)

VII. THE SERVICES’ ARGUMENTS FOR THE *PHONORECORDS II* BENCHMARK SHOULD BE REJECTED

Despite the fact that the *Phonorecords II* benchmark is not an issue for which new evidence was allowed in this proceeding, the Services nevertheless try to resuscitate their argument for adoption of the *Phonorecords II* rates last agreed to a decade ago when the streaming market was embryonic. (*See* Services WP Br. at Point V.)

The Services’ arguments begin with the bare assertion that “[n]othing in the remand proceeding . . . provided the Judges with a reason to reject” the *Phonorecords II* settlement as a benchmark,” and that “neither the Judges nor the Copyright Owners have provided a valid rationale for not adopting the benchmark in its entirety.” (Services WP Br. at 32, 35.) This day-is-night argument requires pretending that the overwhelming evidence in the trial record, exhaustively detailed in the remand, does not exist. The COs and the Board together provided numerous reasons to reject the *Phonorecords II* settlement as a benchmark for rates, with each reason supported by substantial record evidence. (See CO Br. at I.B; CO Reply Br. at I.A.1. and I.B.)

The reasons for rejecting the *Phonorecords II* settlement as a benchmark for rates are discussed thoroughly in COs’ prior submissions and include, but are not limited to: (a) the streaming market at the time of the settlement was dramatically different in every respect from the streaming market at the time of this proceeding;²³ (b) the licensee parties to the settlement were dramatically different than the Service participants in the market with “wider economic ‘ecosystems,’ in which a music service is one part of a multi-product, multi-service aggregation of

²³ On this point, the Services offer only profoundly contradictory positions on what should be rejected as outdated. They argue without any support that the 70-30 industry standard revenue split, which remains standard to the present, should be rejected as “long outdated” because times have changed since 2017 (Services AMO Br. at 13-14.) This is simply incorrect, as even the Services’ own trade group DiMA (whose five members are the five Services who participated in *Phonorecords III*) recently issued an infographic that lists as a “general industry benchmark” for on-demand streaming a 69-31 royalty split. See DiMA, *U.S. On-Demand Subscription Audio Streaming Revenue: Who Gets Paid And How Much*, August 2020, https://dima.org/wp-content/uploads/2020/08/DiMA_Who-Gets-Paid_Infographic.pdf. While this infographic is filled with incorrect assumptions about royalty splits, particularly on the copyright owner side, it reinforces the Services’ understanding that a 70-30 service/copyright owner royalty split remains an industry standard.

Moreover, lost in the Services’ argument that alleged changes since 2017 reflect “long outdated” benchmarks is that the *Phonorecords II* settlement was agreed to in 2012, before any of the Services were meaningfully active in the U.S. market. This same inconsistency arises when the Services argue that the rates should change to address family and student plans because they were “not prevalent” at the time of *Phonorecords II*. (Services’ WP Br. at 37 n.28.) But none of the current Services, and none of the now-dominant streaming business models, were “prevalent” at the time of the *Phonorecords II* settlement. Even under the Services’ own self-serving arguments, the *Phonorecords II* benchmark is hopelessly outdated and unreasonable.

activities,” (FD at 8); (c) the Services failed to submit adequate evidence to support the *Phonorecords II* settlement as a suitable benchmark for rates, including evidence of the parties’ subjective intent in agreeing to the rates (and whether such agreement was based on relevant market considerations) and evidence of how the rates therein were derived (*see id.* at 55-57); and (d) the rates in the *Phonorecords II* settlement were already found by the Majority to be too low.

The Services’ approach of wishing away all of the reasons provided by the COs and the Judges does not make them disappear. Moreover, contrary to the Services’ arguments, the Circuit did not say that the Judges’ rejection of the *Phonorecords II* settlement as a benchmark was not “valid” or “rational.” (Services WP Br. at 34.) Rather, what the Circuit said was: “[B]ecause we cannot discern the basis on which the Board rejected the *Phonorecords II* rates as a benchmark in its analysis, that issue is remanded to the Board for a reasoned analysis.” *Johnson*, 969 F.3d at 387; *see also* CO Br. at I.A. As noted, there are a host of reasons that rejection of that 2012 settlement as a benchmark was correct in 2017, let alone now in 2022, and should not be overturned.²⁴

CONCLUSION

For all of the reasons set forth herein and in COs’ prior submissions in this remand proceeding, COs submit that this remand proceeding should be concluded on the scope of the three agreed issues identified in the Remand Order, and with the implementation of the rates and terms

²⁴ As in their prior remand submissions, the Services repeatedly misrepresent the Dissent, suggesting that it “advocated for wholesale adoption of the benchmark,” including for rates. (Services WP Br. at, *e.g.*, 34-35.) It did not. While the Dissent found the *Phonorecords II* settlement a useful benchmark for the rate *structure*, it found that “if [the *Phonorecords II*] rates should be maintained, support for such result would need to be found elsewhere in the record.” (CO Reply Br. at 14; CO Br. at 28 n.10, citing 84 Fed. Reg. at 2010-11.) Only after examining other record evidence did the Dissent conclude that the rates in the settlement were within a reasonable range, albeit, a range that the Majority and the Circuit rejected. (*Id.*)

PUBLIC VERSION

in the Final Determination, together with changes made by the Board to implement the Music Modernization Act. *See* 84 Fed. Reg. 2031 (Feb. 5, 2019); 84 Fed. Reg. 32296 (July 8, 2019).

Dated: February 24, 2022

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TAB B

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In re

DETERMINATION OF ROYALTY RATES
AND TERMS FOR MAKING AND
DISTRIBUTING PHONORECORDS
(Phonorecords III)

Docket No. 16–CRB–0003–PR
(2018–2022) (Remand)

**COPYRIGHT OWNERS’ BRIEF RESPONDING TO JUDGES’ FEBRUARY 9, 2022
SUA SPONTE ORDER REGARDING ADDITIONAL BRIEFING ON NEW AGENCY
ACTION QUESTION, AND REPLYING TO SERVICES’ NEW AGENCY ACTION
ARGUMENTS IN THEIR JOINT SUPPLEMENTAL BRIEF ADDRESSING THE
JUDGES’ WORKING PROPOSAL**

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Glossary of Abbreviations

Abbreviation	Document
Additional Materials Orders or AMO	Dec. 9 Order and Jan. 6 Order together
CO Br.	Copyright Owners' Initial Remand Submission dated April 1, 2021, eCRB Docket No. 23854, Apr. 1, 2021
CO Clarification Motion	Copyright Owners' Motion for Clarification, eCRB Docket No. 2026, Feb. 12, 2018
CO Reply Br.	Reply Remand Submission of Copyright Owners, eCRB Docket No. 25425, July 2, 2021
COF	Proposed Findings of Fact of Copyright Owners, eCRB Docket No. 3418, May 11, 2017
Dec. 9 Order	Notice and <i>Sua Sponte</i> Order Directing the Parties to Provide Additional Materials, eCRB Docket No. 25965, Dec. 9, 2021
Feb. 9 Order	<i>Sua Sponte</i> Order Regarding Additional Briefing, eCRB Docket No. 26140, Feb. 9, 2022
FD	Final Determination, eCRB Docket No. 3473, Nov. 5, 2018
Initial Determination	Initial Determination, eCRB Docket No. 2288, Mar. 19, 2018
Jan. 6 Order	Order Granting in Part and Denying in Part Copyright Owners' Motion for Reconsideration or, in the Alternative, Clarification, eCRB Docket No. 26007, Jan. 6, 2022
Joint Br.	Services' Joint Submission, Opening Brief, eCRB Nos. 23849 - 53, Apr. 1, 2021
Rehearing Order	Order Granting in Part and Denying in Part Motions for Rehearing, eCRB Docket No. 3603, Jan. 4, 2019
Services WP Br.	Services' Joint Supplemental Brief Addressing Judges' Working Proposal, eCRB Docket No. 26053, Jan. 24, 2022
Working Proposal or WP	Various contemplated rate structures and rates referenced in the Dec. 9 Order and Jan. 6 Order

Copyright Owners (“COs”) respectfully submit this brief in response to the Judges’ February 9, 2022 *Sua Sponte* Order Regarding Additional Briefing, eCRB Docket No. 26140 (the “Feb. 9 Order”), and to reply to the Services’ arguments on new agency action set forth in their January 24, 2022 Joint Supplemental Brief Addressing the Judges’ Working Proposal (“Services WP Br.”).¹

ARGUMENT

I.

THE JUDGES ARE NOT REQUIRED TO JUSTIFY ANY PRIOR AGENCY ACTION WHEN TAKING A NEW AGENCY ACTION

Johnson v. Copyright Royalty Board, 969 F.3d 363 (D.C. Cir. 2020) provides two “alternative directive[s] for addressing the Service Revenue definition.” (Dec. 9 Order at 9.)² The Board may “either [] provide ‘a fuller explanation of [its] reasoning at the time of the [prior] agency action’”—*i.e.*, the Rehearing Order and the FD incorporating the Rehearing Order—or **“take ‘new agency action’ accompanied by the appropriate procedures.”** *Johnson*, 969 F.3d at 392, quoting *DHS v. Regents of the Univ. of Ca.*, 140 S. Ct. 1891, 1908 (U.S. 2020).³

The Services concede that the remand proceeding is a new agency action. (Services WP Br. at 38.) They also concede that the Judges have provided the parties with sufficient procedural opportunities to present additional arguments and evidence on the bundle revenue definition. (*Id.* at 38-39.) Given the undisputed evidence in the record regarding such definition, these

¹ On February 17, at the joint request of the Services and the COs, the Board agreed that the participants’ response to the Feb. 9 Order and their replies to each other’s arguments concerning new agency action contained in their January 24, 2022 submissions concerning the Additional Materials Orders could be addressed together in a single brief separate from their rebuttal submissions on the other issues covered by the Additional Materials Orders.

² Except where defined herein, all capitalized terms are as defined in the COs’ January 24, 2022 Brief in Response to the Additional Materials Orders, eCRB Docket No. 26061 (“CO AMO Br.”). For convenience, a Glossary of Abbreviations is included.

³ Except where otherwise noted, all emphases are added, and all internal citations and quotations are omitted.

concessions lead inexorably to the conclusion that the Judges can—and should—again adopt the adopted bundle revenue definition from the FD on remand.⁴

In their supplemental brief, the Services assert that even though the remand proceeding is a new agency action, the Judges are still bound to the bundle revenue definition set forth in the pre-remand Initial Determination. They base this assertion on two related arguments, both of which are legally and factually baseless. *First*, they conflate the two separate paths provided by *Johnson* concerning the bundle revenue definition, arguing that, in taking *new* agency action, the Judges are required to justify their *prior* agency action by explaining their legal authority for changing the bundle revenue definition at the time of that prior agency action. (Services WP Br. at 38-41.) *Second*, they argue that “no such authority can be identified.” (*Id.* at 41.) This utterly illogical legal *cul de sac* argument—which would render the remand on this issue “without purpose,” and make the inadvertent and erroneous inclusion of the prior bundle revenue definition in the Initial Determination “irredeemable”—has been flatly rejected as “not the law” even by the Services’ own cases. *See Bean Dredging, LLC v. United States*, 773 F. Supp. 2d 63, 79 (D.D.C. 2011). (*See also* CO AMO Br. at 32-33, 36-37.)⁵

⁴ As in the COs’ prior briefs submitted in this remand proceeding, the “adopted bundle revenue definition” means the definition of service revenue adopted by the Board in the FD, Regulatory Terms at 8, and the “prior bundle revenue definition” means the definition of service revenue in the Initial Determination, eCRB Docket No. 2288 (Mar. 19, 2018), which was inadvertently carried over from the Phonorecords II regulations.

⁵ The Services previously made the related argument that any new agency action that offers new reasons for rejecting the prior bundle revenue definition or readopting the adopted bundle revenue definition would be impermissible *post hoc* reasoning under *Regents*. (Joint Br. at 66.) The argument is legally incorrect. *Regents* makes plain that the need to “view[] critically” a new reason to ensure it is not “impermissible *post hoc* rationalization” is limited to situations where the agency chooses the first path, *i.e.*, to offer “a fuller explanation” of the prior agency action at the time of such action (which was the path chosen by the agency in *Regents*). *Regents*, 140 S. Ct. at 1907-08. It is inapplicable where the agency takes new agency action. *Id.*, *see also* CO AMO Br. at 34, citing *Fisher v. Pension Benefit Guar. Corp.*, 994 F.3d 664 (D.C. Cir. 2021); *see also Fisher v. Pension Benefit Guar. Corp.*, 468 F. Supp. 3d 7, 19-20 (D.D.C. 2020), *aff’d*, 994 F.3d 664 (D.C. Cir. 2021) (“Because the Board issued a new decision, the *post hoc* framework . . . [is] inapplicable.”); *Alpharma, Inc. v. Leavitt*, 460 F.3d 1, 6 (D.C. Cir. 2006) (*post hoc* justification doctrine “is not a time barrier which freezes an agency’s exercise of judgment after an initial decision has been made and bars it from further articulation.”).

PUBLIC VERSION

The Services’ arguments are not only contrary to the explicit identification of two paths in *Johnson*, but they also distort the meaning of “new agency action” and ignore the recent caselaw on new agency action following the Supreme Court’s decision in *Regents*.

Contrary to the Services’ assertions, *Johnson* does **not** say that if the Judges take new agency they must nevertheless justify the prior, vacated agency action on grounds available to the Judges at the time of the prior action but that are no longer applicable. Only if the Judges choose the first, “fuller explanation” path must they justify the source of their legal authority to change the prior bundle revenue definition at the time of the Rehearing Order and Final Determination, *i.e.*, their legal authority under 17 U.S.C. § 803(c), which was applicable at that point in time. As COs have explained (CO AMO Br. at 35-36), Section 803(c) is irrelevant at this point in time, as the Final Determination was vacated, and the remand is not a rehearing or a correction of the Rehearing Order or Final Determination. It is a new proceeding that, as the Services admit, constitutes a new agency action in which the Judges can and did hear argument and evidence on the issue and can now “deal with the problem afresh.” *Regents*, 140 S. Ct. at 1908.

The Services’ argument that the “vacated question” was limited to “the source of the Judges’ authority for altering the Service Revenue definition in the Initial Determination” (Services WP Br. at 39-40) is both factually and legally incorrect. One path provided by *Johnson* allows the Judges to identify their legal authority for making the change they made at the time they made it. But the other path provided by *Johnson* allows the Judges to take new agency action unconstrained by the requirements applicable to rehearings (or corrections or modifications under section 803(c)(4)), provided the Judges follow “appropriate procedures.” *Johnson*, 969 F.3d at 392. Taking new agency action to adopt an appropriate bundle revenue definition based on the existing

record, as that evidence might be supplemented by any additional evidence the parties chose to provide, and after hearing argument, is thus entirely responsive to the Circuit’s mandate.

Case law makes clear that an agency taking new agency action is not so constrained as the Services pretend. (*See* CO AMO Br. at 33-39, citing and discussing cases.) The Services continue to cite *Fisher* and *Bean Dredging, LLC*. But those cases in fact reject the Services’ argument and instead support COs’ argument.

In *Fisher*, the agency denied the appellant’s request for payment of a lump sum pension benefit, “primarily relying on Policy 5.4-9, Section D-1 of [the agency’s] Operating Policy Manual.” *Fisher*, 994 F.3d at 668. The appellant challenged the denial in the federal district court, and the district court vacated and remanded because the agency, *inter alia*, failed to consider whether the application of Policy 5.4-9 was consistent with ERISA. *Id.* On remand, the agency “reexamined the administrative record” and took new agency action, once again denying appellant’s request without explaining whether Policy 5.4-9 was consistent with ERISA. Instead, the agency relied on 29 CFR §4044.4(b) to deny the request. *Id.* at 668-69. The Circuit upheld the new agency action. It did not say the agency failed to respond to the reviewing court’s mandate because it did not explain whether Policy 5.4-9 was consistent with ERISA. *See id.*

Similarly, in *Bean Dredging*, the federal district court remanded to the agency for further explanation as to its reasons for *rejecting* Bean Dredging’s preferred interpretation of the term “seas” in the applicable regulation. *Bean Dredging, LLC*, 773 F. Supp. 2d at 78. On remand, the agency issued a new determination that *accepted* Bean Dredging’s preferred interpretation of the term “seas” but nevertheless still denied Bean Dredging’s claim on other grounds. *Id.* The reviewing court affirmed the new agency action and did not say the agency did not respond to its mandate because it did not explain why it had previously rejected Bean Dredging’s statutory

interpretation. *Id.* See also *Lewis v. U.S. Army Corp. of Engineers*, No. CV 18-1838, 2021 WL 1401756 (E.D. La. Apr. 14, 2021) (agency determination that plaintiff’s property was subject to regulation under Clean Water Act remanded because agency failed to support finding that sufficient nexus existed between plaintiff’s property and a downstream navigable waterway; on remand, agency did not revise previous determination to establish significant nexus; rather, agency took new agency action and issued a new determination finding that 80.5% of plaintiff’s land was wetlands subject to Clean Water Act, which new agency action was upheld by the reviewing court); *Black Warrior Riverkeeper, Inc. v. EPA*, No. 2:19-cv-00344-JHE, 2021 WL 927260, at *6 (N.D. Ala. Mar. 11, 2021) (agency not required to explain reason for prior agency action when taking new agency action); *Friends of the River v. Nat’l Marine Fisheries Serv.*, No. 216CV00818JAMJDP, 2020 WL 6391314, at *2 (E.D. Cal. Nov. 2, 2020) (notwithstanding that Circuit directed remand of prior agency opinion “for fuller explanation,” agency “may also choose to change its approach by adopting a new” opinion).⁶

The Services feign concern that were the Judges to follow *Johnson’s* directive to take new agency action and, consistent with the case law, “deal with the problem afresh” by adopting an appropriate bundle revenue definition supported by evidence and legal authority, it would “nullify the express limits put on the Judges’ ability to alter an Initial Determination.” (Services WP Br. at 41.) This is simply the Services’ unsupported *cul de sac* argument expressed differently. Whatever limits may have existed as to the Judges’ authority to alter the Initial Determination absent a motion for rehearing, those limits do not exist on remand where the Board is expressly authorized by the Circuit’s mandate to take “new agency action” unconstrained by the

⁶ *Ali v. Pompeo*, No. 16-CV-3691-SJB, 2020 WL 6435834 (E.D.N.Y. Nov. 2, 2020), the only other case the Services cite, is plainly distinguishable. (CO AMO Br. at 38 n. 40.) In that case, the agency completely ignored the reviewing court’s express directive to consider the petitioner’s Fifth Amendment arguments. (*See id.*)

requirements applicable to section 803(c)(2) and (c)(4), which concern rehearings and amendments, not new agency actions.

Moreover, the Services' feigned concern seems uniquely applicable only to the changes to the Initial and Final Determinations they do not like since they themselves are seeking changes through this remand via their improper new rate proposal, including changes regarding determinations that were not even appealed let alone remanded. (CO Reply Br. at 67-69.) And framing the Services' arguments is the fact, nowhere disputed by the Services, that the undisputed evidence in the record establishes that the bundle revenue definition that was initially carried forward in the Initial Determination was manifestly unreasonable. The evidence established that

[REDACTED]

[REDACTED] (CO

Br. at 75-90; CO Reply Br. at 80-82.) The Services do not even attempt to argue that the prior bundle revenue definition was reasonable or supported by any evidence, only that the Board somehow is foreclosed, even when taking new agency action, from adopting a different definition. According to the Services, the Judges are stuck with a substantively unreasonable—and unsupportable—definition because of a procedural mistake in the initial proceeding, and there is nothing that the Judges or anyone else can do about it, even though the Judges are now taking a new agency action based on new arguments and whatever new evidence the parties may choose to submit, and even though the Circuit remanded to the Judges to do just that. Nothing in law or logic supports such a blinkered view, and to readopt the prior bundle revenue definition despite all of the record evidence showing that it is unreasonable and contrary to authority would be the very definition of “arbitrary and capricious” and the opposite of “reasoned decisionmaking.” *Regents*, 140 S. Ct. at 1905; *United Food & Co. Workers Union, Loc. No. 663 v. United States Dep't of*

Agric., 532 F. Supp. 3d 741, 769 (D. Minn. 2021) (“An agency action that is ‘arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law’ shall be held unlawful and ‘set aside’”); *Black Warrior Riverkeeper, Inc.*, 2021 WL 927260, at *1 (an “agency action may be found arbitrary and capricious if the agency has . . . offered an explanation for its decision that runs counter to the evidence before the agency”).

II.

THE JUDGES MAY TAKE NEW AGENCY ACTION THROUGH A RECONSIDERATION OF THE 2018 CO CLARIFICATION MOTION AS A MOTION FOR REHEARING, BUT SUCH AN APPROACH IS UNNECESSARY

The Judges have asked whether engaging in new agency action as permitted under *Johnson* allows them to do so “through a reconsideration of [COs’] February 12, 2018 Motion for Clarification [eCRB Docket No. 2026 (“CO Clarification Motion”)] as a Motion for ‘rehearing,’ pursuant to 17 U.S.C. § 803(c)(2)(A) and 37 C.F.R. §353.1.” (Feb. 9 Order.)

Respectfully, while for the reasons discussed below the Judges have the authority and may do so, proceeding in that fashion would add an entirely unnecessary and complicating step. There is no need to reconsider or recharacterize the CO Clarification Motion as a motion for rehearing because the remand itself affords the opportunity for the Board to take “new agency action,” which, as in a rehearing, permits them to reconsider evidence and arguments, but, unlike a rehearing, is not limited by the constraints of Section 803(c)(2). A decision rendered after a remand proceeding that considers all of the arguments and evidence presented by the participants on this issue—both in the existing record and any additional evidence the parties choose to provide (and here, the parties relied on the existing evidence in the record)—and that “deal[s] with the problem afresh,” *Regents*, 140 S. Ct. at 1908, is precisely the “new agency action” authorized by *Johnson*.⁷ And,

⁷ As the Judges noted in the Jan. 6 Order, the Judges provided participants the opportunity to submit additional evidence as well as briefing on the bundle revenue definition issue. (Jan. 6 Order at 7 n. 10.) However, the cases

for the reasons discussed above, such new agency action does not need to explain or justify the Judges' prior agency action taken in response to the CO Clarification Motion, because such new agency action will be a new decision based on both the existing record and any new arguments and new evidence the parties choose to submit. (*See also* CO AMO Br. at 34-37.)

If the Judges nevertheless wish to take an unnecessary extra step and now engage in new agency action to reconsider the CO Clarification Motion as a motion for "rehearing" under 803(c), and to decide that motion based on all of the evidence in the record supporting the adopted bundle revenue definition and showing the prior bundle revenue definition to be unsupported and unreasonable, COs submit that they may do so. The COs did not in the CO Clarification Motion—which concerned numerous aspects of the Initial Determination and was not solely focused on the bundle revenue definition—request rehearing or seek relief under 803(c)(2). (Rehearing Order at 1-2; *see also, generally*, CO Clarification Motion.) Because they did not seek rehearing, the Judges concluded that the COs had not met the standard for a rehearing motion. (Rehearing Order at 2.)

However, the failure to meet the standard because rehearing was not sought is not the same as a finding that the standard could not have been met, and the Board may consider whether, based on the evidence in the record, the rehearing standard has been satisfied on this remand.⁸ The COs have demonstrated beyond any doubt on remand that the prior bundle revenue definition was not

make clear that the opportunity to submit additional evidence is not a prerequisite to new agency action. *See Fisher*, 994 F. 3d at 670 (upholding new agency action after remand even though agency did not provide appellant opportunity to submit new briefing or exhibits); *Bean Dredging, LLC*, 773 F. Supp. 2d at 74-75 (upholding new agency action adopting new interpretation after remand even though agency did not give plaintiff "an opportunity to submit any new information, evidence or argument").

⁸ The Services' argument (Joint Br. at 66) that the COs waived any right to argue that the rehearing standard has been met because they did not appeal the Board's finding that it was not met is wrong. The Board adopted the COs' favored bundle revenue definition and so COs had no reason to appeal the issue. It was the Services that appealed and, as the case the Services cited holds, COs cannot be penalized for not making every possible argument for affirmance. *Crocker v. Piedmont Aviation, Inc.*, 49 F.3d 735, 739-40 (D.C. Cir. 1995). The Services' argument (Joint Br. at 65), that Section 803(c)(2) requires that a motion for rehearing have been made for the Judges to grant rehearing is also wrong. That section requires only that a motion have been made by a participant, and the COs made a motion for clarification or correction of certain regulatory terms, which satisfies the provision.

only unsupported by evidence, but shown by the evidence to be manifestly unreasonable.⁹ It was shown to be a “loophole” that Services [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

(CO AMO Br. at 41-42; CO Br. at 75-90; CO Reply Br. at 80-82.) And it was shown to fail to address the economic indeterminacy problem inherent in bundling, and to violate prior Board precedent. (CO AMO Br. at 41-43; CO Br. at 91-92; CO Reply Br. at 72-73, 86-88.) The adopted revenue definition, on the other hand, is well-supported by the evidence—including evidence as

⁹ The Services failed at the hearing and on remand to support the prior bundle revenue definition with any evidence, including “evidence of how they price bundles and value the component parts” and that “concern[s] the proper economic allocation of bundled revenue,” and thus “might mitigate the acknowledged ‘economic indeterminacy’ problem inherent in bundling” in a manner consistent with Board precedent. (CO AMO Br. at 39-40, citing and quoting authorities). It was the Services’ burden to present such evidence, as it “would be in [their] possession, not in the possession of” Copyright Owners. (*Id.*, citing and quoting authorities.) But the Services *conceded* that they offered no evidence concerning the separate values of the constituent parts of the bundles that they offer or wish to offer, or any other evidence concerning the economic allocation of bundled revenue. (*Id.*, citing Joint Br. at 76 (admitting that Services did not submit any “evidence specifically addressing the way that customers, Services, or copyright owners might ‘value the component parts’ of bundles”).)

The only evidence the Services ever cited to during this remand to support the prior bundle revenue definition is evidence that supports, at most, the alleged benefits of the *practice or strategy of bundling*, not evidence that supports their preferred bundle revenue definition, because there is no such evidence. (*Id.* at 40 n. 41.)

The Services’ only other argument in support of the prior bundle revenue definition is that it is purportedly a “bright-line, easily administered rule” (Joint Br. at 68), and that any definition other than the prior definition will have “tremendous administrative complexity—involving costly and lengthy audits for all bundles,” especially for Prime Music, which purportedly “has no standalone equivalent.” (*Id.* at 75.) As the COs have explained (CO Reply Br. at 83), this argument is not only unsupported by any evidence, but also completely backwards. The prior definition, which permitted deduction of values for any number of non-music components, is far more complicated and difficult to administer, and far more likely to lead to audits given that the indeterminacy problem applies to *multiple* non-music products or services. Also, the values of non-music components that are to be deducted under the prior definition (*e.g.*, Amazon’s Prime Delivery service, which also is not offered on a standalone basis) are more likely to have no standalone equivalent, and are susceptible to the Services [REDACTED]. (CO Br. at 84, citing COF-553; Tr. 1481:24-1484:18 (Mirchandani).) And, of course, the argument ignores that the adopted bundle revenue definition contemplates the very situation where there may be a service that has no precise “comparable.” In those cases, the service is permitted to use the average standalone published price for “the most closely comparable product or service in the U.S. or, if more than one comparable exists, the average of standalone prices for comparables.” (CO AMO Br. at 45.)

to how the Services price the music component of their bundles—and relevant legal precedent. (CO AMO Br. 44-46; CO Br. at 91-92; CO Reply Br. at 72-73, 86-88.)

Accordingly, the Judges could conclude, revisiting on remand the question of whether the rehearing standard has now been met, that the COs have satisfied the “exceptional case” standard for granting rehearing motions under Section 803(c)(2).¹⁰ The Judges can reach that conclusion by taking a new agency action that reconsiders the CO Clarification Motion as a motion for rehearing, provided that the Judges fully explain their reasoning. *See United Food & Com. Workers Union, Loc. No. 663*, 532 F. Supp. 3d at 769 (“When an agency takes a new course of action, it must ‘display awareness that it *is* changing position’ and ‘show that there are good reasons for the new policy.’”), quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis in original). But, again, taking this approach would needlessly conflate the two alternative paths identified in *Johnson* for addressing this issue, *i.e.*, providing a “fuller explanation” of the prior agency action and taking “new agency action.” There is no need to address the prior agency action (including the Rehearing Order) at all if the Board takes new agency action and adopts the new bundle revenue definition consistent with the evidence in the record. Nor must the Board justify that new agency action under the 803(c) rehearing standard, which is no longer relevant nor applicable.

¹⁰ The Board could also rely on Section 803(c)(4) and provide an explanation of why the definition was an “unforeseen circumstance” that, absent its change, “would frustrate the proper implementation of the Board’s determination,” which it plainly would. *Johnson* did not foreclose such a path. *Johnson* noted that “[t]he [rehearing] order never mentions Section 803(c)(4) or unforeseen circumstances as the basis for revamping the Service Revenue definition.” *Johnson*, 969 F.3d at 391. And it noted as well that the Board’s “briefing to this court also did not explain what unforeseen circumstances permitted the term to be modified.” *Id.* The remand order thus left room for the Board to now provide, as a fuller explanation, why the change in the bundled revenue definition was warranted as the prior definition, based on the evidence, would “frustrate the proper implementation of the Initial Determination.” *Id.*

CONCLUSION

For all of the reasons set forth herein and in COs' prior submissions in this remand proceeding, the Judges should not readopt the bundle revenue definition inadvertently included in the Initial Determination and should instead adopt the bundle revenue definition included in the Final Determination.

Dated: February 24, 2022

Respectfully submitted,

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TAB C

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In re

**DETERMINATION OF RATES
AND TERMS OF MAKING AND
DISTRIBUTING PHONORECORDS
(Phonorecords III)**

**Docket No. 16-CRB-0003-PR
(2018-2022) (Remand)**

**ADDITIONAL WRITTEN REBUTTAL TESTIMONY OF
JEFFREY A. EISENACH, PH.D.**

Expert Witness for Copyright Owners

February 24, 2022

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APPENDICES

Appendix A: Materials Relied Upon
Appendix B: Assessment of Spotify Non-Content Costs

COPYRIGHT OWNERS' REMAND EXHIBITS

Exhibit Y: Amendments to Spot. Rem. Ex. 1 (Agreement between [REDACTED]
[REDACTED])

Exhibit Z: Amendments to Spot. Rem. Ex. 2 (Agreement between [REDACTED]
[REDACTED])

Exhibit AA: Amendments to Spot. Rem. Ex. 3 (Agreement between [REDACTED]
[REDACTED])

I. INTRODUCTION AND SUMMARY OF FINDINGS

1. My name is Jeffrey A. Eisenach. I submit this testimony on behalf of the National Music Publishers' Association ("NMPA") and Nashville Songwriters Association International ("NSAI") (together referred to as "Copyright Owners").¹

A. Assignment

2. I have been asked by counsel for Copyright Owners to review the Written Supplemental Remand Testimony of Dr. Michael L. Katz (Katz WSRT),² the Second Supplemental Written Remand Testimony of Dr. Gregory K. Leonard (Leonard SSWRT),³ and the Written Second Supplemental Remand Testimony of Dr. Leslie M. Marx (Marx WSSRT)⁴ (together the Service Experts) and to assess the economic arguments and opinions put forth therein. As with my AWDT, these testimonies from the Service Experts were written in response to the Board's December 9, 2021 order⁵ and its January 6, 2022 order,⁶ and relate to Board's "Working Proposal" discussed therein.

3. In forming my views, I have relied upon the materials set forth at Appendix A to this report.

¹ I submitted Written Direct Testimony in the *Phonorecords III* proceeding ("Eisenach WDT") on October 31, 2016, Written Rebuttal Testimony ("Eisenach WRT") on February 13, 2017, Supplemental Written Rebuttal Testimony ("Eisenach SWRT") on March 1, 2017, Written Rebuttal Testimony in this Remand proceeding ("Eisenach RWRT") on July 2, 2021, and Additional Written Direct Testimony ("Eisenach AWDT") on January 24, 2022. My qualifications were detailed in Eisenach RWRT, which also included a copy of my curriculum vitae.

² Michael L. Katz, *In the Matter of Determination Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, Docket No. 16-CRB-0003-PR (2018-2022) (Remand) ("Phonorecords III Remand"), *Written Supplemental Remand Testimony of Michael L. Katz (on Behalf of Pandora Media, LLC)* (January 24, 2022) ("Katz WSRT").

³ Gregory K. Leonard, *Phonorecords III Remand, Second Supplemental Written Remand Testimony of Dr. Gregory K. Leonard* (January 24, 2022) ("Leonard SSWRT").

⁴ Leslie M. Marx, *Phonorecords III Remand, Written Second Supplemental Remand Testimony of Leslie M. Marx, Ph.D.* (January 24, 2022) ("Marx WSSRT").

⁵ U.S. Copyright Royalty Judges, *Phonorecords III Remand, Notice and Sua Sponte Order Directing the Parties to Provide Additional Materials* (December 9, 2021) (hereafter "Additional Materials Order").

⁶ U.S. Copyright Royalty Judges, *Phonorecords III Remand, Order Granting in Part and Denying in Part Copyright Owners' Motion for Reconsideration or, in the Alternative, Clarification* (January 6, 2022) (hereafter "Clarification Order").

B. Summary of Findings and Structure of This Testimony

4. My primary findings and opinions include the following:⁷

- The Service Experts continue to claim that the major labels have “complementary oligopoly power” and that rates are above effectively competitive rates, but present no evidence or even argument in support of this position. Their claims are incorrect and are inconsistent with the Judges’ finding that sound recording rates are determined by “give and take negotiations” between labels and Services.
- The Service Experts’ contentions that the Services are at or near “survival rates” are both incorrect and inconsistent with their argument that sound recording rates will not react to changes in musical work rates (i.e., that there is no “see saw” effect). The Services are not at or near their survival rates, but sound recording rates will nevertheless react to changes in musical works rates.
- The Service Experts present no support for their proposed “market power adjustments,” nor do they propose (let alone support) any specific magnitude for such an adjustment.
- The Service Experts present no support for the 3.82:1 sound recording to musical works ratio put forward in the Working Proposal; and, their efforts to justify a still higher ratio are not supported by either economic analysis or the record in this proceeding.
- Professors Marx and Dr. Leonard’s proposed combined royalty rate inputs are both unfounded and biased downwards. As I explain in detail, the record supports a combined royalty rate of 70 percent or higher.
- There is no “imbalance problem” and no need for an “imbalance correction.” Even if one accepted that an imbalance problem could exist in theory (which I do not), the empirical evidence demonstrates that it does not exist in fact.
- The Service Experts’ proposal to return to the *Phonorecords II* rate structure makes no economic sense particularly given the fundamental changes in the music streaming marketplace over the past decade.
- Professor Katz’s contention that a rate structure with minimums and floors will result in excessive royalties is exactly wrong; to the contrary, minimums and floors are required to prevent effective rates from falling below appropriate levels given the growing problem of revenue displacement and deferral.

5. The remainder of this testimony is organized as follows. In Section II, I explain why the Service Experts’ discussions of market power and survival rates are both erroneous and internally

⁷ The summary below is not intended to be comprehensive; the full range of my findings is as expressed in the body of this testimony.

inconsistent. Section III shows that Professor Marx and Dr. Leonard's proposals to use higher sound recording to musical works rates are erroneous. In Section IV, I present my analysis of the combined royalty rate inputs put forward by Professor Marx and Dr. Leonard and show that they are significantly biased downward. Section V addresses the "imbalance problem" and explains why no "correction" is warranted. Section VI addresses the Service Experts' contentions regarding a return to the *Phonorecords II* rates and Dr. Katz's argument regarding the impact of minimums and floors. Section VII presents a brief conclusion.

II. THE SERVICE EXPERTS' DISCUSSIONS OF MARKET POWER AND "SURVIVAL RATES" ARE BOTH ERRONEOUS AND INTERNALLY INCONSISTENT

6. The Service Experts all assert two arguments. First, they reference the theory that Major record labels have "complementary oligopoly power," which would allow them to extract virtually all of the value of the bargain from the Services. Second, they assert that the rates set by the labels are not "survival rates," such that increases in musical works rates must necessarily be reflected in lower sound recording rates (i.e., there is no significant "see saw" effect). Thus, they argue that a "complementary oligopoly correction" should be applied to market-based benchmarks, and also that it should be assumed that any increase in musical works rates will be fully borne by the Services. These two economic arguments are directly in conflict with each other. As I explain in this section, the evidence indicates that the rates negotiated between the labels and the Services reflect a give and take between parties with reasonably balanced bargaining power, and (as the Service Experts sometimes acknowledge) are not "survival rates." Further, because the labels bargain with the Services over the value of the surplus created by their collaboration, and because that value is directly affected by the musical works rate, increases in the musical works rate will be taken into account by the labels and the Services in their negotiations.

A. The Service Experts' Attacks on the Working Proposal Are Inconsistent with the Assumption of Strong Complementary Oligopoly Power

7. The Service Experts present virtually no evidence or even argument to support a contention that sound recording royalties are above effectively competitive rates, preferring instead to invoke

the mantra of “complementary oligopoly power” without any attempt at proof. As I have explained previously, the evidence demonstrates that the Services are not “price takers” but rather engage in negotiations with the record labels.⁸ Moreover, as the Judges recognized in *Web V* (based in part on the Services’ own admissions), the negotiations are not one-sided affairs in which the labels “dictate terms” and [REDACTED]

[REDACTED] which is “not consistent with the one-sided negotiations between complementary oligopolists and their relatively powerless counterparties.”⁹

8. Given their heavy reliance on the existence of “complementary oligopoly power” (Professor Katz invokes the term nine times, Dr. Leonard six and Professor Marx eight), the extent to which it has been challenged by both the Judges and by other economic experts, and the Judges’ specific request for analysis on whether any such alleged power should affect their analysis,¹⁰ I would have expected the Service Experts to dedicate at least some portion of their testimonies to defending this central assumption. Instead, in the course of their attempts to deny the existence of a strong see saw effect, each of them now downplays its significance. Professor Katz, for example, reiterates his admission that the bargaining power of the labels is attenuated by asymmetric information, which prevents them from even *knowing* how much surplus the Services have to be appropriated, let alone capturing all of it.¹¹ Dr. Leonard, in the course of criticizing the Working

⁸ See Eisenach AWDT at ¶¶ 35-36; see also Daniel Spulber, *Phonorecords III Remand, Additional Written Direct Testimony of Daniel F. Spulber, Ph.D.* (January 24, 2022); Richard Watt, *Phonorecords III Remand, Additional Written Direct Testimony of Richard Watt (PHD)* (January 24, 2022) at ¶¶ 50-57 (hereafter “Watt AWDT”).

⁹ U.S. Copyright Royalty Judges, *In re Determination of Rates and Terms for Digital Performance of Sound Recordings and Making of Ephemeral Copies to Facilitate Those Performances (Web V), Initial Determination*, Docket No. 19-CRB-0005-WR (2021-2025) (June 11, 2021) at 64-65.

¹⁰ See *Clarification Order* at 12.

¹¹ Katz WSRT at ¶19. See also *Phonorecords III Remand, Transcript of Videotape Deposition Via Zoom of Michael L. Katz Before the United States Copyright Royalty Judges* (June 8, 2021) at 90 [REDACTED]

[REDACTED] Professor Katz also notes that if the labels had sufficient market power to dictate royalty rates, the Services would have no incentive to participate in this proceeding. See Katz WSRT at ¶6.

Proposal's assumption of a strong see-saw effect, explains that the "underpinning" of this assumption is that "the labels have such strong complementary oligopoly power that they can extract from the services all surplus that remains after the services have covered their costs and paid the statutory musical works royalties."¹² Professor Marx also criticizes the rate-setting algorithm in the Working Proposal for assuming that the major labels will "dictate the amount that the services will retain and leave them just enough to survive."¹³

B. The Service Experts' Concerns About Maintaining "Survival Profits" Are Inconsistent with Their Opinions About Weak or Non-Existent "Complementary Oligopoly Power," and with the Economic Evidence

9. In my RWRT, I presented extensive evidence demonstrating that the Services were not only *not* disrupted by the implementation of the *Phonorecords III* rates during rate activity period; to the contrary, rather they prospered.¹⁴ That is, I demonstrated that to the extent the term "survival rate" (introduced by the Services) suggests a condition in which the Services are failing to earn

¹² Leonard SSWRT at ¶5.

¹³ Marx WSSRT at ¶30. In a footnote, Professor Marx asserts that "unregulated negotiations" will not produce rates consistent with the 801(b) factors because of "the consolidation of rights to a large number of individual musical works by a small number of publishers, the must-have nature of their catalogs, their resulting complementary oligopoly power, their connections with major record labels who themselves have must-have catalogs and complementary oligopoly power, and the extensive split-ownership of musical works copyrights, which increases the number of rights holders that have veto power over an individual musical work." Marx WSSRT at ¶21, n. 26. However, she offers no analysis or explanation of how these characteristics translate into bargaining power that would allow the Copyright Owners to demand royalties above effectively competitive rates.

Furthermore, at the hearing, Professor Marx testified that she had not formed an opinion on effective competition in the sound recording market. See *Phonorecords III*, Hearing Transcript (April 7, 2017) at 5646:5-12 ("

[REDACTED]

As the Judges have also explained, the compilation of repertoires, which substantially reduce transaction costs for the Services, is not a sound basis for reducing royalties. See e.g., Copyright Royalty Board, *Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings (Web IV), Final Determination*, Docket No. 14-CRB-0001-WR (2016-2020), 81 FR 26316, 26368 (May 2, 2016) ("There is absolutely no record evidence to suggest that the market power that a Major enjoys individually by ownership of its collective repertoire is in any sense the consequence of improper activity or that it is being used individually by a Major to diminish competition.")

¹⁴ Eisenach RWRT at Section II.B.

economic returns on their investments, the evidence demonstrates that the royalties they are paying are well below that rate.¹⁵

10. Despite denying the labels have sufficient “complementary oligopoly power” to extract all of the surplus in negotiations, the Service Experts are not thereby deterred from speculating that royalties may be sufficiently close to survival rates that even a modest increase could cause the Services dire harm, resulting in “less than survival revenue,” “industry disruption” and even “exit.”¹⁶

11. These speculations are unpersuasive for a number of reasons, including that they directly conflict with the empirical evidence that the Services are earning healthy returns. Moreover, the Service Experts themselves opine that the labels do not actually have sufficient market power to impose “survival” rates on the Services. Thus, rather than offering an expert economic opinion that the Services are in any way endangered, the Service Experts appear to be engaged in a “what if” exercise based on a predicate they do not actually believe to be correct.¹⁷

C. The Service Experts’ Proposed Market Power “Adjustments” Are Unnecessary and Without Support

12. While providing no economic predicate for making a “market power adjustment” of any magnitude, and despite offering opinions that the labels’ bargaining power is so small as to imply a trivial or non-existent see-saw effect, the Service Experts do not hesitate to propose unspecified adjustments designed to “fix” the assumed problem. Their arguments are without merit and their failure even to specify the magnitude of such an adjustment is a tacit admission that there is no economic support for a correction of any size.

¹⁵ Dr. Leonard asserts that, “the ‘survival’ level of total royalty rate should be the rate that would allow the services to cover their long-run economic costs, including an appropriate risk-adjusted return on capital employed.” Leonard SSWRT at ¶17. This interpretation effectively defines “survival” to be success, and a “survival rate” as something any company should be happy to obtain. The evidence I offered in my RWRT also shows that the Services earn profits at or above this level, including throughout the P3 Rate Activity Period. See Eisenach RWRT at Section II.B.

¹⁶ See, e.g., Katz WSRT at ¶22-23; Leonard SSWRT at ¶6; Marx WSSRT at ¶21.

¹⁷ I also note, as I have previously, that the Services themselves have expressly refused to invoke the “disruption” criterion in these remand proceedings. See Eisenach RWRT at ¶9, n. 16.

13. As a preliminary matter, it is important to recall that the *Final Determination* utilized Shapley-based values to set the percentage of revenue rate, and Shapley methodology abstracts from “must-have” market power.¹⁸ Further, the Judges discounted the TCC rate by [REDACTED] percent – approximately triple the “adjustment” used in *Web IV* – to address alleged complementary oligopoly power, although no service expert offered any economic proof of a lack of effective competition.¹⁹ Thus, the rates in the *Final Determination* were explicitly designed by the Judges to surpass any “effective competition” standard. The further corrections now proposed by the Service Experts have no economic basis, but appear designed simply to get to lower rates.

14. The lack of economic support for a “market power adjustment” is further demonstrated by the fact that neither Dr. Leonard nor Professor Marx puts forward a specific proposal for how large such an adjustment ought to be. Rather, each of them merely refers to the [REDACTED] percent adjustment in the *Web IV* determination and the [REDACTED] percent (for Spotify) and [REDACTED] percent (for the other Services) adjustments in *Web V*.²⁰ Their failure to embrace these (or any other) specific adjustments may be a result of the fact that the Judges have already explained that those cannot be assumed here because they were based on evidence specific to a different market,²¹ but it is also

¹⁸ U.S. Copyright Royalty Judges, *In re Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, Docket No. 16-CRB-0003-PR (2018-2022) (“*Phonorecords III*”), *Final Determination* (November 5, 2018) (hereafter “*Final Determination*”) at 62-63, 86.

¹⁹ *Final Determination* at 73-75. The *Final Determination* relied upon a 2.5:1 ratio of sound recording to musical works to compute the 15.1 percent percentage of revenue rate. This ratio implies a percentage of TCC rate of [REDACTED] percent. The *Final Determination* discounted this [REDACTED] percent percentage of TCC rate by [REDACTED] percent to 26.2 percent [REDACTED]. See also Eisenach AWDT at ¶37, n. 46.

²⁰ See Leonard SSWRT at ¶24 and Marx WSSRT at ¶32.

²¹ See *Final Determination* at 54 (“The Judges are reluctant to simply import the 12% rate reduction from *Web IV* into other determinations, even though that figure was used to adjust from interactive streaming rates to noninteractive streaming rates. The specific 12% figure was based on record evidence derived from steering experiments and agreements analyzed in *Web IV*.”) The Judges reached a similar conclusion in their *SDARS III* determination. See Copyright Royalty Board, *Determination of Royalty Rates and Terms for Transmission of Sound Recording by Satellite Radio and “Preexisting” Subscription Services (SDARS III)*, *Final Determination*, Docket No. 16-CRB-0001 SR/PSSR (2018–2022), 83 FR 65210, 65237 (December 19, 2018) (“The Judges cannot simply import the 12% steering adjustment from *Web IV* into the satellite market; that 12% figure was derived from highly specific evidence presented in *Web IV*. There is not an adequate basis in the present record to support a finding that the noninteractive market from which that steering adjustment arose is sufficiently similar to the satellite radio market to render reasonable an importation of the 12% steering adjustment here.”)

consistent with their ambivalence about the extent of label and service market power revealed in their current testimonies.

III. PROFESSOR MARX AND DR. LEONARD'S EFFORTS TO PROMOTE A HIGHER SOUND RECORDING TO MUSICAL WORKS RATIO IN THE WORKING PROPOSAL ARE BIASED AND UNFOUNDED

15. In my AWDT I explained why the Working Proposal's use of a 3.82:1 sound recording to musical works ratio is contrary to the record evidence and the reasoning of the *Final Determination*, and why the economically appropriate approach is to apply the 2.5:1 ratio established in the *Final Determination*.²² While the Service Experts sometimes rely upon the 3.82:1 ratio, they offer no economic analysis or support for its adoption.²³ Their failure to do so suggests they share my conclusion that it is not economically supportable based on the record evidence.

16. The arguments of Dr. Leonard and Professor Marx on behalf of an even higher ratio – specifically either the [REDACTED] ratio based on the “opt-out” rates for Pandora’s non-interactive service, or the ratio implied by the Subpart A settlement in both *Phonorecords III* and *Phonorecords IV* – are equally unsupported.²⁴ Both of these ratios lie [REDACTED] [REDACTED] discussed in the *Final Determination* based upon the evidence at the hearing, yet neither Dr. Leonard nor Professor Marx offers new evidence or provides any economic basis for their opinions: Dr. Leonard simply labels his approach “a superior alternative,”²⁵ while Professor Marx declares without explanation that the “3.82:1 ratio ... should be replaced with a real-world

²² Eisenach AWDT at Section II.

²³ Professor Marx refers to the 3.82:1 ratio as having been “identified” in the *Final Determination* but provides no economic support for why it should replace the 2.5:1 ratio the Majority actually applied. See Marx WSSRT at ¶4, n. 6. Furthermore, Professor Marx explains, as I do in my AWDT, that it was Professor Gans’ 2.5:1 ratio formed the basis for the 15.1 percent percentage of revenue rate, which, in turn, was used to derive the 26.2 percent percentage of TCC rate – i.e., it was not the 26.2 percent percentage of TCC rate that derived the 15.1 percent percentage of revenue rate. See Marx WSSRT at ¶4, n. 6 (“The 3.82-to-1 ratio is derived by starting with the [REDACTED] ratio taken from Professor Gans’ Shapley-inspired model and then adjusting it so that when the ratio is applied to the assumed all-in royalty rate of [REDACTED], the resulting musical works rate equals the musical works royalty rate from the Majority’s model: 15.1%. The 15.1% was derived by the Majority by multiplying the all-in royalty rate of [REDACTED]% derived from one Marx Shapley model by the [REDACTED] ratio used in the Gans Shapley-inspired model.”); Eisenach AWDT at Section II.A.

²⁴ See Leonard SSWRT at ¶¶23-25; Marx WSSRT at ¶¶31-36.

²⁵ Leonard SSWRT at ¶23.

ratio in which both the numerator and denominator are intended to approximate those that would emerge in an effectively competitive market.”²⁶ Furthermore, neither Dr. Leonard nor Professor Marx explain why, when picking among market-based sound recording to musical works ratios that were considered but ultimately not relied upon by the Board in the *Final Determination*, they choose to consider only the higher ratios while ignoring the lower ones. The only apparent reason is that doing so supports the result they seek to justify.

17. In my opinion, the 2.5:1 ratio established in the *Final Determination* – which is derived from Professor Gans’s Shapley analysis – is consistent with both the record evidence and with relevant economic principles. The Service Experts present no sound economic basis for departing from this rationale or from the *Final Determination*’s finding that the correct sound recording to musical works ratio is 2.5:1.

IV. PROFESSOR MARX AND DR. LEONARD’S PROPOSED COMBINED ROYALTY RATE INPUTS ARE BIASED AND UNFOUNDED

18. In this section I present my assessment of Professor Marx and Dr. Leonard’s arguments relating to the appropriate combined royalty rate to be used in calculating a percentage of revenue rate. As I explain, the rates they propose are biased downwards, which has the effect of unreasonably reducing the implied percentage of revenue rate that emerges from the Working Proposal’s rate algorithm.

A. Professor Marx’ Recommended Royalty Rate Inputs Are Biased Downwards

19. Professor Marx presents her analysis of the correct royalty rate inputs (i.e., combined royalty rates) in Section III of her report. For the reasons I explain below, her analysis is fundamentally flawed.

1. Professor Marx’ Estimate Using Non-Content Costs Is Incorrect

20. One of the pillars of Professor Marx’ effort to justify a low Combined Royalty Rate for use in the Working Proposal’s algorithm is her assumption that an appropriate measure of Spotify’s

²⁶ Marx WSSRT at ¶31.

non-content costs is [REDACTED] of revenue, which she bases on a single Spotify spreadsheet of global financial data from Q4 2017, which the Services did not include as an exhibit to any report. Professor Marx proposes using this [REDACTED] as an estimate of Spotify’s “survival rate,”²⁷ from which she calculates a Combined Royalty Rate of [REDACTED] (the remainder after subtracting [REDACTED] from 100 percent).²⁸ As I explain below, [REDACTED] is neither an accurate measure of Spotify’s non-content costs nor a sound basis for estimating a reasonable Combined Royalty Rate.

21. First, Professor Marx conspicuously ignores available data on Spotify’s actual U.S. costs in favor of inferring [REDACTED] U.S. costs from global data.²⁹ For Q4 2017, Spotify’s actual U.S. non-content costs were [REDACTED].³⁰ Based on Professor Marx’ analysis, this would imply a Combined Royalty Rate of [REDACTED], in line with my own estimates.

22. The [REDACTED] content cost figure implied by the U.S. data for Q4 2017 is also consistent with Spotify’s overall global cost data and with Spotify’s public statements across the *Phonorecords III* rate period – which, as I explain in the next section, is the appropriate time period for consideration. As I show in Appendix B, publicly available data on Spotify’s global costs support my conclusion that Spotify’s actual global non-content costs during the *Phonorecords III* rate

²⁷ Marx WSSRT at ¶13.

²⁸ Marx WSSRT at Figure 2.

²⁹ Professor Marx’ decision to rely on global data is notably inconsistent with her contention that Professor Watt’s reliance on global data was a “source of unreliability” in his Shapley analysis. See Leslie M. Marx, *Phonorecords III Remand, Written Direct Remand Testimony of Leslie M. Marx, PhD* (April 1, 2021) at ¶43 (hereafter “Marx WDRT”). [REDACTED]

[REDACTED] See Watt WRT at ¶33, n. 21 (“

[REDACTED]...”); *Clarification Order* at 10 (“Professor Watt also cites Spotify financial data that he understood to indicate that music services’ non-content costs would fall to [REDACTED] % of ‘Service Revenue’ during the *Phonorecords III* rate period.”) (cited in Marx WSSRT at ¶10, n. 10).

³⁰ See SPOTRMND0006752 ([REDACTED]); CO Rem. Ex. D. [REDACTED], conversion to USD through X-Rates, *US Dollar per 1 Euro Monthly Average* (available at <https://www.x-rates.com/average/?from=EUR&to=USD&amount=1&year=2017>).

period are [REDACTED], which is consistent with my estimates and with the cross-industry standard of 70 percent combined royalties.³¹

23. Further, Spotify openly admits that “profit margin is a managed outcome,” meaning that it chooses consciously to defer profitability in order to achieve growth; put differently, Spotify could choose to earn a profit at any time simply by reducing non-content costs (such as marketing, geographic expansion, and investment in features and functionality) or by collecting rather than deferring certain revenues.³²

24. The upshot of Spotify’s “managed outcome/profit deferral” strategy is [REDACTED]. Indeed, the data on which Professor Marx relies demonstrates precisely this phenomenon, as they show [REDACTED],³³ implying content and non-content costs together of [REDACTED]. Yet, just a few months later, in April 2018, Spotify had a successful initial public offering (IPO) which valued the

³¹ Eisenach WDT at ¶¶168, 171; Eisenach WRT at ¶79; *Clarification Order* at 9. While I understand that Spotify did not produce U.S. cost data for the *Phonorecords III* rate period, Spotify’s global costs are available through its public filings.

³² See Eisenach RWRT at ¶50 (citing CO Rem. Ex. I Spotify Q3 2018 Earnings Call (Transcript) (November 1, 2018) at 6 (“If you think back to our commentary during Investor Day, I made two important points. One is **profit margin is a managed outcome**. It’s a by-product of the pace we choose to invest in new features and functionality to drive growth. Second point is the three ways to invest in growth, one is marketing, two is geographic expansion, which we’re pursuing aggressively, and three is investment in features and functionality....”) (emphasis added)). Moreover, as I have previously explained, Spotify has accumulated cash balances [REDACTED] aggregate U.S. mechanical royalty pools since its inception. See Eisenach RWRT at ¶ 46-51; CO Rem Ex. K. Indeed, its most recent reports indicate that cash and cash equivalents increased by \$1.812 billion during calendar 2021 (see Spotify Technology S.A., *Shareholder Letter Q4 2021* (February 2, 2022) at 10 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Shareholder-Letter-Q4-2021_FINAL.pdf); X-Rates, *Euro Historical Rates Table: 2021-12-31* (available at <https://www.x-rates.com/historical/?from=EUR&amount=1&date=2021-12-31>)), which reflects the unreliability of using accounting profits as a measure of economic success. Spotify has also incurred significant costs to build its podcasting business. See e.g., Anne Steele, “Spotify Strikes Podcast Deal With Joe Rogan Worth More Than \$100 Million,” *The Wall Street Journal* (May 19, 2020) (available at <https://www.wsj.com/articles/spotify-strikes-exclusive-podcast-deal-with-joe-rogan-11589913814>) (“Spotify has spent hundreds of millions of dollars acquiring entire companies, including Gimlet Media and Bill Simmons’s the Ringer. The deal with Mr. Rogan is a multiyear licensing agreement for an amount of time that couldn’t be learned. It will likely be worth more than \$100 million based on milestones and performance metrics, according to the person familiar.”).

³³ In Q4 2017, Spotify’s global content costs were [REDACTED] and its global revenue was approximately €1,149,000,000. See SPOTRMND0006751 (cell M13); CO Rem. Ex. J at 8. [REDACTED] / €1,149,000,000 = [REDACTED].

company at \$26.5 billion, far higher than earlier valuations – indicating investors did not view its short-run accounting profits as a sound economic measure of its value.³⁴ Therefore, if anything, the accounting data relied upon by Professor Marx points to a Combined Royalty Rate of [REDACTED], not an inferred rate of [REDACTED] that ignores Spotify’s business model and actual gains.

25. Lastly, the evidence shows that Spotify’s non-content costs overstate industry costs, since larger Services like Amazon and Google almost certainly have lower costs than Spotify.³⁵ For example, in his February 2017 WRT, [REDACTED]

[REDACTED]³⁶ Under Professor Marx’ (still flawed) methodology, these suggest Combined Royalty Rates of [REDACTED]³⁷ and, using the 2.5:1 ratio, musical works revenue rates of [REDACTED].³⁸ Neither Professor Marx nor any other witness disputes the accuracy of these internal Amazon cost estimates.

2. Professor Marx’ Results Are Incorrectly Biased Downward by the Use of 2017 Contracts and the Limitation to Headline Rates

26. A central premise of Professor Marx’ approach to assessing combined royalty rates is that it is appropriate to rely solely on 2017 data. As she explains:

Because contracts are long-term and not renegotiated continuously, and because market parameters are constantly moving, even if one thought that a “survival rate” for a service could be derived from observed market rates, one could only rely on observed market rates being close to that service’s survival rate at the time that the service’s sound recording contract is being negotiated.³⁹

³⁴ See CO Rem. Ex. J at 2; Chuck Mikolajczak and Stephen Nellis, “Spotify Shares Jump in Record-Setting Direct Listing,” *Reuters* (April 3, 2018) (available at <https://www.reuters.com/article/us-spotify-ipo/spotify-shares-jump-in-record-setting-direct-listing-idUSKCN1HA12B>); Hal R. Varian, *Intermediate Microeconomics with Calculus*, 1st ed. (New York and London: W. W. Norton & Company, 2020) at 370 (“The total stock market value of a firm represents the present value of the stream of profits that the firm is expected to generate.”).

³⁵ See also Watt WRT at ¶33, n. 21.

³⁶ Watt WRT at ¶33, n. 21 (citing CO Ex. R-24 (AMZN00053095-53106)).

³⁷ [REDACTED]

³⁸ [REDACTED]

³⁹ Marx WSSRT at ¶15. Note that Dr. Leonard makes a similar argument. See Leonard SSWRT at ¶¶19-20.

27. Based on this argument, Professor Marx calculates a range of Combined Royalty Rates by adding together all pairwise combinations of the headline and effective “musical works rates at the time of the renegotiations” [REDACTED], based on *Phonorecords II* rates, and “the sound recording rates that immediately followed” those renegotiations.⁴⁰ Doing so, she arrives at a lower bound of [REDACTED] percent ([REDACTED] and an upper of bound [REDACTED] percent ([REDACTED]).⁴¹

28. The first and most obvious problem with this approach is that [REDACTED] after the *Phonorecords III* rates were announced in January 2018 and before the appeal decision was announced in August 2020.⁴² That is, the market rates observed during this period are the rates that were in place “at the time the service’s sound recording contract [was] being negotiated.”

⁴⁰ Marx WSSRT at Figure 2 and ¶¶14-19.

⁴¹ Marx WSSRT at Figure 2.

⁴² *Johnson v. Copyright Royalty Bd.*, 969 F.3d 363 (D.C. Cir. 2020). Specifically, [REDACTED] percent percentage of revenue royalty rate, has been [REDACTED]. See Spot. Rem. Ex. 1; Exhibit Y. [REDACTED]. See Spot. Rem. Ex. 3; Exhibit AA. [REDACTED]

See Spot. Rem. Ex. 2; Exhibit Z. Spotify’s Global Head of Label and Rights & Clearances Business Affairs Christopher Bonavia confirmed that [REDACTED]. See Christopher Bonavia, *Phonorecords III Remand, Written Direct Remand Testimony of Christopher Bonavia (on Behalf of Spotify USA, Inc.)* (March 31, 2021) at ¶¶17-19 (hereafter “Bonavia WDRT”). [REDACTED]

[REDACTED] Horacio Gutierrez, Spotify’s general counsel, who as I noted in my written rebuttal testimony and additional written direct testimony, has stated publicly that a Combined Royalty Rate “over 70%” is “as it should be.” See Exhibits Y, Z, AA; Eisenach WRT at ¶79; Eisenach AWDT at ¶27 (citing Hearing Exhibit 2745, Loren Shokes, *Interview with Spotify General Counsel Horatio Gutierrez*, Harvard Journal on Sports & Entertainment Law (Dec. 19, 2016), <http://harvardjsel.com/2016/12/interview-with-spotifygeneral-counsel-horacio-gutierrez/>).

29. A second problem with Professor Marx' approach is that it "focuses primarily" on headline rates, [REDACTED] and thus further bias her results downward. Her explanation for this approach is that headline rates "capture in a straightforward way what a label was asking for at the time the contract was negotiated."⁴³

30. Professor Marx' focus on headline rates is inconsistent with economic theory, [REDACTED], and inconsistent with her own prior testimony. From an economic perspective, it is reasonable to expect that negotiators will focus on the price actually paid, taking into consideration all of the terms of the contract – that is, the effective rate. From [REDACTED]⁴⁴ And, from Professor Marx' (previous) perspective, her argument in her WDRT that [REDACTED]⁴⁵.

31. A more reasonable approach to calculating the Combined Royalty Rates Professor Marx is seeking to estimate would be to add effective label rates to the fully implemented *Phonorecords III* 15.1 percent of revenue musical work rate.⁴⁶ Spotify's Benjamin Kung, a Director in Financial Planning & Analysis, testified that Spotify [REDACTED]

⁴³ Marx WSSRT at ¶16.

⁴⁴ Bonavia WDRT at ¶12. See also *id.* at ¶20 ("[REDACTED]"). See also Kung WDRT at ¶4.

⁴⁵ Marx WDRT at ¶¶49-50; Bonavia WDRT at ¶¶17-19. Note that Professor Marx clarified in her deposition testimony that this opinion was [REDACTED]. See Eisenach RWRT at ¶32, n. 54. In my RWRT, I showed that Professor Marx' claims [REDACTED] are incorrect. See Eisenach RWRT at ¶¶31-43.

⁴⁶ See n. 42, *supra*, explaining that [REDACTED]. Here I rely on the fully implemented (i.e., 2022) *Phonorecords III* headline rate for musical works royalties because the fully implemented *Phonorecords III* rates have not yet been applied to the Services' royalty pool calculation inputs, so there is no historical data on which to rely for an effective musical works rate under the fully implemented *Phonorecords III* rates.

percent of revenue in 2020.⁴⁷ Thus, under Professor Marx' own approach, a more appropriate measure would be to add the [REDACTED] percent [REDACTED] to the [REDACTED] percent musical work rate, which results in a Combined Royalty Rate of [REDACTED] percent.⁴⁸ Applying this rate to the Working Proposal (with the correct 2.5:1 SR/MW ratio) implies a musical works rate of [REDACTED] percent.⁴⁹ Moreover, these [REDACTED], each of whose witnesses testified to agreeing to sound recording rates of [REDACTED] percent of revenues after the *Final Determination* issued, implying combined royalty rates of at least [REDACTED] percent under Professor Marx' approach.⁵⁰

32. Lastly, I note in her discussion of observed combined royalty rates, Professor Marx cites but fails to discuss the 70 percent industry standard benchmark that I discussed in my Written Direct Testimony, which was noted by the Judges in the *Clarification Order*.⁵¹ Her testimony offers no explanation for this omission, but does assert that my finding was "without citation."⁵² To the contrary, I provided a factual foundation for this conclusion in both my Direct Report and

⁴⁷ Benjamin Kung, *Phonorecords III Remand, Written Direct Remand Testimony of Benjamin Kung (on Behalf of Spotify USA, Inc.)* (March 31, 2021) at ¶8 (hereafter "Kung WDRT"). Prof. Marx' suggestion that [REDACTED] would not know the effective revenue rate of these deals is unreasonable. See Marx WSSRT at ¶16. [REDACTED], and the royalty statements under those rates and terms of course reveal the effective royalty rate.

⁴⁸ As discussed in my RWRT, the combined royalty rate during the P3 Rate Activity Period was also *lower* than the combined rate during the *Phonorecords II* period, disproving the Services' arguments in their initial remand submission. See Eisenach RWRT at Section II.A.

⁴⁹ [REDACTED]
⁵⁰ See, e.g., Rishi Mirchandani, *Phonorecords III Remand, Supplemental Testimony of Rishi Mirchandani (on Behalf of Amazon.com Services LLC)* (March 31, 2021) at ¶20; Waleed Diab, *Phonorecords III Remand, Written Direct Remand Testimony of Waleed Diab (on Behalf of Google LLC)* (April 1, 2021) at ¶8; George White, *Phonorecords III Remand, Written Direct Remand Testimony of George White* (April 1, 2021) at ¶¶18, 21, 24-27.

⁵¹ *Clarification Order* at 9. While Dr. Marx includes the 70 percent benchmark in her summary of rates discussed by in the Board's Orders in Figure 1 of her testimony, she omits it from the "potential alternative inputs" listed in Figure 2.

⁵² Marx WSSRT at Figure 1.

my Written Rebuttal Testimony.⁵³ And as I have shown above, Professor Marx' own analysis when appropriately corrected, is consistent with this benchmark.⁵⁴

B. Dr. Leonard's Proposed Combined Royalty Rates Are Unreasonably Biased Downward

33. Dr. Leonard proposes three Combined Royalty Rates as inputs for computing a musical works rate: [REDACTED] percent, [REDACTED] percent, and [REDACTED] percent.⁵⁵

34. The [REDACTED] percent and [REDACTED] percent rates are the lower and upper bounds of a range Spotify's former Chief Financial Officer (CFO) Barry McCarthy testified in 2016 would [REDACTED] assuming Spotify [REDACTED].⁵⁶ Mr. McCarthy stated that his assessment was [REDACTED] and said that it related to [REDACTED].⁵⁷ Thus, the only basis for Dr. Leonard's [REDACTED] percent and [REDACTED] percent inputs is five-year-old testimony offered in the context of a rate-setting proceeding [REDACTED]. Further, Dr. Leonard ignores the fact that this testimony conflicts directly with the public statements of Spotify's former general counsel, Horacio Gutierrez ([REDACTED]).

⁵³ Eisenach WDT at ¶168 ("I note that it is accepted, and indeed publicly proclaimed by some services, that services pay approximately 70 percent of revenue to rightsholders – which in the case of interactive streaming means simply two groups: publishers/songwriters and labels. At the time of the launch of Apple Music, Apple stated that it will pay 71.5 percent of its streaming revenues to rightsholders in the United States. Spotify has repeatedly stated that it pays 70 percent of revenues to rightsholders."); see also Eisenach WRT at ¶79 and Eisenach AWDWT at ¶33, Table 1 ([REDACTED]).

⁵⁴ Dr. Leonard critiques my observation that 70 percent of revenue is the "industry standard" by arguing that [REDACTED] Leonard SSWRT at ¶22. As explained above, [REDACTED] are consistent with the 70 percent benchmark.

⁵⁵ Leonard SSWRT at ¶¶17, 20, 26.

⁵⁶ Barry McCarthy, *Phonorecords III, Written Direct Testimony of Barry McCarthy (on Behalf of Spotify USA Inc.)* (October 31, 2016) at ¶¶28-29 (hereafter "McCarthy WDT"). [REDACTED]

[REDACTED], as Mr. McCarthy testified, Spotify's content costs would need to be no more than [REDACTED].

⁵⁷ McCarthy WDT at ¶¶28-29.

[REDACTED]),⁵⁸ who has stated publicly outside the context of litigation that a Combined Royalty Rate “over 70%” is “as it should be.”⁵⁹

35. In Appendix B, I present further evidence on Spotify’s costs-of-goods sold (COGS) from Spotify’s shareholder letters, which shows that Spotify’s other COGS as a percentage of revenue has been declining in recent years, providing more room for Spotify to meet its long-term gross margin goals. This evidence is also consistent with the evidence presented in my RWRT, that “Spotify’s gross margins were higher during the P3 Rate Activity Period” than in 2016 or 2017, during the *Phonorecords II* rate period.⁶⁰ Spotify has also acknowledged that its U.S. margins are even higher.⁶¹

36. Furthermore, the current CFO of Spotify is Paul Vogel. His prepared remarks for Spotify’s Q4 2021 earnings call indicate no concerns about Spotify’s long-term gross margins or ability to achieve long-term viability and sustainability due to royalties:

Looking at our full year 2021 margin of 26.8%, we made meaningful progress relative to the 25.6% we reported in 2020. Full year 2021 did benefit from close to 50 bps of favorable royalty adjustments. However, even excluding this item, GM was still an improvement year on year.... Looking into 2022, we expect a continuation of the favorable Gross Margin trend you saw in 2021 for our underlying business.... as we grow advertising and drive further growth in marketplace contribution.... [I]t is exactly this progress that has given us the conviction to increase our investments in certain areas and gives us confidence that we’re on the right path over the long-term.⁶²

37. Dr. Leonard’s proposed [REDACTED] percent Combined Royalty Rate has the same basis as Professor Marx’ proposed [REDACTED] percent rate (Spotify’s [REDACTED] plus the 10.5 percent headline *Phonorecords II*

⁵⁸ See Exhibits Y, Z, AA.

⁵⁹ See Eisenach WRT at ¶79; Eisenach AWDT at ¶27 (citing Hearing Exhibit 2745, Loren Shokes, *Interview with Spotify General Counsel Horatio Gutierrez*, Harvard Journal on Sports & Entertainment Law (Dec. 19, 2016), <http://harvardjsel.com/2016/12/interview-with-spotifygeneral-counsel-horacio-gutierrez/>).

⁶⁰ Eisenach RWRT at Figure 12 and ¶48.

⁶¹ Eisenach RWRT at ¶48 (citing CO Rem. Ex. I Spotify 2018 Q2 Earnings Call (Transcript) (July 26, 2018)).

⁶² Spotify, *Q4 2021 Earnings Call Prepared Remarks* (February 2, 2022) at 3 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Q421-Earnings-Remarks.pdf). Professor Marx did not consider Mr. McCarthy’s [REDACTED] as a potential Combined Royalty Rate input (perhaps because it is not consistent with the reality of Spotify’s financial situation, as described by its current CFO, Mr. Vogel).

rate). For the reasons discussed above with respect to Professor Marx' testimony, a Combined Royalty Rate of at least [REDACTED] and the 15.1 percent *Phonorecords III* rate for 2022, [REDACTED] would be more correct, though this figure still [REDACTED].⁶³

V. PROFESSOR MARX' PROPOSED IMBALANCE CORRECTION LACKS EITHER THEORETICAL OR EMPIRICAL SUPPORT

38. Professor Marx also asserts that there is an "imbalance problem" with how revenue is allocated to the Services and Copyright Owners under both the *Final Determination* and the Working Proposal.⁶⁴ The supposed "problem" is that the musical works rate set by the *Final Determination* and Working Proposal provides for the Copyright Owners to receive a certain allocation of revenue, but the Services are not guaranteed a certain allocation of revenue because the Services' final allocation also depends on the royalty rate paid to the labels (as well as all of the other decisions that the Services make regarding their costs, pricing and business models).⁶⁵ As I explain below, there are at least two problems with Professor Marx' proposed correction. First, the asserted problem is founded on the premise that the labels extract "unfair" rates based on their complementary oligopoly power. Second, Professor Marx' assertion that the Judges determined that the Services "deserve" [REDACTED] percent of revenues is incorrect.

A. There Is No Imbalance Problem to Correct

39. The underlying premise behind Professor Marx alleged imbalance problem is that the labels are able to extract royalties in excess of the effectively competitive rate, leaving the Services and Copyright Owners to divide up an "unfairly" reduced pie.⁶⁶ For the reasons I have explained

⁶³ [REDACTED]

⁶⁴ Marx WSSRT at ¶¶25-29; Marx WDRT at ¶¶57-63; Professors Katz and Leonard make similar assertions. See e.g., Katz WSRT at ¶8, Leonard SSWRT at ¶¶10-12.

⁶⁵ Marx WSSRT at ¶¶25-29.

⁶⁶ Marx WSSRT at ¶26 ("Given that the supracompetitive rates charged by sound recording rights holders exceed [REDACTED]% (the residual available after [REDACTED]% is allocated to interactive streaming services and [REDACTED]% to musical works rights holders), a problem with simply allocating [REDACTED]% to the interactive streaming services is that musical works rights holders would receive less than their 'fair' return; analogously, simply allocating [REDACTED]% to the musical works rights holders would leave the Services with less than their 'fair' return").

above, the Service Experts have failed to produce any economic support for this premise, even after the Judges specifically asked for such evidence in the *Additional Materials Order*. Furthermore, as I noted, Professor Marx explicitly disclaimed having reached any conclusions about whether label rates are effectively competitive in her trial testimony.

40. To the extent Service Experts claim that rates need to be adjusted downwards to reflect the “retroactive” nature of this proceeding, they are also incorrect.⁶⁷ As I explained above, the sound recording royalties currently being paid [REDACTED] to the issuance of the *Final Determination* and [REDACTED] based on that finding.

B. Professor Marx Errs by Relying on a [REDACTED] Percent Combined Royalty Rate

41. Professor Marx’ proposed methodology for “correcting” the non-existent imbalance problem is premised on the assumption that the Judges determined that the Services should retain [REDACTED] percent of revenues.⁶⁸ This assumption is incorrect for at least three reasons.

42. First, as the *Additional Materials Order* explicitly states, “the Judges do not find it appropriate to include in their analysis Professor Marx’ assumption that the Services should retain [REDACTED] % of the revenue generated by streaming.”⁶⁹ As I explained in my AWDT, I agree with this conclusion, as Professor Marx’ analysis leading to [REDACTED] percent combined royalties fundamentally conflicts with the market evidence as well as proper Shapley analysis.⁷⁰

43. Furthermore, contrary to Professor Marx’ claims, the Board’s finding in the *Final Determination* does not “include[] a ‘fair’ return to the Services of [REDACTED] %.”⁷¹ The portion of the *Final Determination* cited by Professor Marx to support this claim only refers to the rates derived from the [REDACTED] percent Combined Royalty Rate and Professor Gans’s 2.5:1 ratio of sound recording

⁶⁷ Katz WSRT ¶¶3, 6; Leonard SSWRT at ¶¶13-14; Marx WSSRT at ¶9.

⁶⁸ Marx WSSRT at ¶¶25-29, Figure 3.

⁶⁹ *Additional Materials Order* at 3, n. 5.

⁷⁰ Eisenach AWDT at Section III; see also Joshua Gans, *Phonorecords III, Written Rebuttal Testimony of Joshua Gans on Behalf of Copyright Owners* (February 13, 2017); Richard Watt, *Phonorecords III, Written Rebuttal Testimony of Richard Watt (Ph.D.) on Behalf of the National Music Publishers’ Association and the Nashville Songwriters Association International* (February 13, 2017) (hereafter “Watt WRT”).

⁷¹ Marx WSSRT at ¶25.

to musical work royalties (i.e., 15.1 percent of revenue and 26.2 percent of TCC) as “fair.”⁷² In fact, the reason why the Board considered the “top value” of Professor Marx’ range of Combined Royalty Rates of [REDACTED] percent to be “a lower bound for total royalties in computing a royalty rate,” is because they found that “the total royalty values produced by Professor Marx’ models understate what would be a fair allocation of surplus to upstream content providers.”⁷³ As is evident in the calculation of the 26.2 percent of TCC rate, the Board was well aware that the actual Combined Royalty Rate in their analysis was far higher than [REDACTED] percent, and they relied on [REDACTED] percent actual Combined Royalty Rate in their adjusted TCC rate derivation,⁷⁴ which implies an allocation to the Services of [REDACTED] percent ([REDACTED]).

44. Third, in the *Final Determination*, the Judges also considered the lowest Combined Royalty Rate from Professor Watt’s Shapley model, which was [REDACTED] percent.⁷⁵ If the [REDACTED] percent Combined Royalty Rate is used in place of [REDACTED] percent in Professor Marx’ formulas, leaving her other assumptions in place, the resulting musical works rate (“corrected for the imbalance problem”) is between [REDACTED] 15.1 percent set established in the *Final Determination*.⁷⁶ Indeed, in order for Professor Marx’ flawed “imbalance correction” to yield a rate below 15.1 percent, one would need to assume a Combined Royalty

⁷² *Final Determination* at 87.

⁷³ *Final Determination* at 75; Eisenach AWDt at ¶13.

⁷⁴ *Final Determination* at 71-73; Eisenach AWDt at ¶¶16-17.

⁷⁵ *Final Determination* at 75; Eisenach AWDt at ¶13.

⁷⁶ Applying this flawed approach to a Combined Royalty Rate of [REDACTED] percent and a ratio of 2.5:1 imply an allocation to the Services of [REDACTED] and a musical work rate of [REDACTED]. Using the same formula as in Marx WSSRT Figure 3, the Copyright Owners would retain [REDACTED] of what remains for the Services and Copyright Owners to split after sound recording royalties are paid. When using a sound recording rate of [REDACTED] percent of revenue, there would be [REDACTED] percent of revenue remaining for Copyright Owners and Services to split, meaning that the Copyright Owners would retain [REDACTED]. When using a sound recording rate of [REDACTED] percent of revenue, there would be [REDACTED] percent of revenue remaining for Copyright Owners and Services to split, meaning that the Copyright Owners would retain [REDACTED].

Rate of 61.6 percent or less, [REDACTED]

[REDACTED]⁷⁷

VI. OTHER ISSUES

45. In this section, I address the Service Experts' unfounded proposals to revert to the *Phonorecords II* rates and Dr. Katz' erroneous contention that the presence of floors and minimums in the rate structure would lead to excessive royalties.

A. There Is No Economic Support for Reverting to the *Phonorecords II* Rates

46. All three of the Service Experts urge the Judges to jettison the *Phonorecords III* rate structure entirely in favor of the *Phonorecords II* structure.⁷⁸ In my WDT and WRT, I explained in detail why the *Phonorecords II* structure is not a comparable bargain and does not satisfy the 801(b)(1) criteria, including because it was negotiated in 2012 and the musical works marketplace had changed dramatically in the interim. That rationale is even stronger today, when the interactive streaming market is dominated by platform companies like Amazon, Apple and Google – none of which was engaged at all in interactive streaming at the time of the *Phonorecords II* agreement.⁷⁹

B. Dr. Katz's Contention that Alternative Prongs Result in Excessive Royalties Is Precisely Backwards

47. Professor Katz argues that the use of alternative prongs should be avoided because it could lead to effective total royalties in excess of the Services' "survival rates."⁸⁰ Specifically, he states that "if the Working Proposal is correct that the effective rate pushes the Services to earning their

⁷⁷ Marx WSSRT at Figure 2. Applying this flawed approach to a Combined Royalty Rate of [REDACTED] percent and a ratio of 2.5:1 imply an allocation to the Services of [REDACTED] and a musical work rate of [REDACTED]. Using the same formula as in Marx WSSRT Figure 3, the Copyright Owners would retain [REDACTED] of what remains for the Services and Copyright Owners to split after sound recording royalties are paid. When using a sound recording rate of [REDACTED] percent of revenue, there would be [REDACTED] percent of revenue remaining for Copyright Owners and Services to split, meaning that the Copyright Owners would retain [REDACTED].

⁷⁸ See Katz WSRT at ¶25; Leonard SSWRT at ¶28; Marx WSSRT at ¶24.

⁷⁹ See *In the Matter of Adjustment or Determination of Compulsory License Rates for Making and Distributing Phonorecords, Motion to Adopt Settlement*, Docket No. 2011-3 CRB Phonorecords II (April 12, 2012); Eisenach RWRT at ¶13, n. 19; CO. Rem. Ex. A-B; Hearing Exhibit 2839, Sai Saichin R, "Apple to Pay 70 Percent of Music Subscription Revenue to Labels, Publishers," *Reuters* (June 15, 2015) (available at <http://www.reuters.com/article/us-apple-music-idUSKBN0OV1VX20150615>) (last accessed Oct. 12, 2016).

⁸⁰ Katz WSRT at ¶¶14-16.

survival revenue level, then using that effective rate as the headline statutory rate and failing to account for the presence of binding floors and minimums would push Services' revenues below their survival levels.”⁸¹ The obvious problem with this assertion is that, as I have explained above (and as Professor Katz at least sometimes appears to agree), there is no evidence that the Services are paying or (regardless of the outcome of this proceeding) royalty rates that approach “survival rates.” But there is also a second problem: As I have shown in detail with substantial empirical evidence, multiple rate prongs are necessary to deliver fair royalties because Service revenues are an unreliable and manipulable proxy for value, including because revenue deferral and displacement can cause declared revenues to significantly understate the actual value of the use of musical works rights to the Services.⁸² Moreover, as Professor Katz acknowledges, neither the labels *nor the Judges* are well positioned to assess the relevant financial parameters and adjust headline revenue rates to address the problem.⁸³ In this context, the fact that alternative rate prongs exist and may push effective rates above headline revenue rates is not a bug, it is a feature that is critical to delivering reasonable royalties.

VII. CONCLUSION


48. For the reasons I have explained above, the arguments and opinions put forward by the Service Experts in response to the Board's December 9 and January 6 requests are unfounded and erroneous.

⁸¹ Katz WSRT at ¶16.

⁸² See e.g., Eisenach WDT at ¶53; Eisenach WRT at ¶¶83-102; Eisenach RWRT at ¶15-16 and Section III.B.

⁸³ Katz WSRT at ¶19.

I, Jeffrey A. Eisenach, declare under penalty of perjury that the statements contained herein are true and correct to the best of my knowledge, information and belief. Executed on January February 24, 2022 in OAKTON, VIRGINIA.



Jeffrey A. Eisenach

APPENDIX A

Materials Relied Upon

Academic Books and Journal Articles

Hal R. Varian, *Intermediate Microeconomics with Calculus*, 1st ed. (New York and London: W. W. Norton & Company, 2020).

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Barry McCarthy, *In the Matter of Determination Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), Written Direct Testimony of Barry McCarthy (on Behalf of Spotify USA Inc.)*, Docket No. 16-CRB-0003-PR (2018-2022) (October 31, 2016).

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Jeffrey Eisenach, *In the Matter of Determination Rates and Terms for Making and Distributing Phonorecords (Phonorecords III), Supplemental Written Rebuttal Testimony of Jeffrey Eisenach, Ph.D.*, Docket No. 16-CRB-0003-PR (2018-2022) (March 1, 2017).

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U.S. Copyright Royalty Judges, *In re Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, Final Determination, Docket No. 16-CRB-0003-PR (2018-2022) (November 5, 2018).

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U.S. Copyright Royalty Judges, *In re Determination of Royalty Rates and Terms for Making and Distributing Phonorecords (Phonorecords III)*, Order Granting in Part and Denying in Part Copyright Owners' Motion for Reconsideration or, in the Alternative, Clarification, Docket No. 16-CRB-0003-PR (2018-2022) (Remand) (January 6, 2022).

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APPENDIX B

Spotify's non-content costs as a percentage of revenue since Q4 2017 are not provided directly by Spotify. However, they can be estimated with confidence, and [REDACTED].

The non-content costs included in Professor Marx' calculation consist of two main components: [REDACTED]⁸⁴ [REDACTED]

[REDACTED]⁸⁵ Spotify's global total operating expenses as a percentage of revenue for Q1 2017 through Q3 2020 can be calculated using the exhibit Professor Marx cites for Q4 2017 revenue.⁸⁶ Total global operating expense as a percentage of global revenue was at a high point in Q4 2017 at 32.1 percent.⁸⁷ This is an outlier data point, and the annual average was never that high over the period.⁸⁸ Rather, in the only other quarters through Q3 2020 ([REDACTED]) when it has been higher than 32.1 percent, Q2 2018 and Q2 2020,⁸⁹ there were

⁸⁴ See Marx WSSRT at ¶13, n. 18 ("[REDACTED]").

⁸⁵ SPOTRMND006751 (see lines 29, 44, 63).

⁸⁶ CO Rem. Ex. J at 8, 20, 32, 45, 57, 69, 83, 97, 112, 128, 142.

⁸⁷ CO Rem. Ex. J at 45. Note that the total operating expenses relied upon by Professor Marx are [REDACTED]. See SPOTRMND006751 ([REDACTED]); CO Rem. Ex. J. at 8 ([REDACTED]).

⁸⁸ CO Rem. Ex. J at 45, 97, 142. This is also true when including more recent data for full-year 2020 and 2021. Average annual operating expenses were 29.3 percent in 2020 and 25.8 percent in 2021. See Spotify Technology S.A., *Shareholder Letter Q4 2021* (February 2, 2022) at 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Shareholder-Letter-Q4-2021_FINAL.pdf).

⁸⁹ CO Rem. Ex. J at 69, 142. Operating expense as a percentage of revenue was also never higher than 32.1 percent in the more recent period from Q4 2020 through Q4 2021. Over that period, it ranged from 23.7 percent in Q3 2021 to 29.7 percent in Q4 2020. See Spotify Technology S.A., *Shareholder Letter Q2 2021* (July 28, 2021) at 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q2/Shareholder-Letter-Q2-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q3 2021* (October 27, 2021) at 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q3/Shareholder-Letter-Q3-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q4 2021* (February 2, 2022) at 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Shareholder-Letter-Q4-2021_FINAL.pdf).

“higher than expected social charges” (in other words, high payouts to employees who had stock options and the like) due to “strong stock performance” that significantly increased operating expenses.⁹⁰ This was also the case in the next three highest quarters of operating expense as a percentage of revenue after Spotify’s IPO in Q2 2018: Q1, Q2, and Q4 2019.⁹¹ Excluding these five quarters where Spotify’s strong stock performance led employees to cash out stock options and inflate operating expenses, operating expenses as a percentage of revenue averaged 26.5 percent over the period – [REDACTED] the Q4 2017 data point relied upon by Professor Marx.⁹²

⁹⁰ CO Rem. Ex. J at 12 (“Our Operating Loss was €90 million or approximately 7% of Total Revenue. This includes a €30 million cash expense related to our direct listing on the NYSE in April...and €32 million of accrued social costs for options and RSUs [restricted stock units] (€24 million more than anticipated in our Q2 guidance as a result of the strong stock performance in the quarter). Excluding increased accrued social costs for options and RSUs, Operating Loss would have been at the low end of our guidance.”); CO Rem. Ex. J at 121-122 (“Reported operating expense was significantly higher than forecast as a result of the accrual of higher than expected social charges related to the strong gains in our stock price during the quarter.”). According to Spotify, “[S]ocial costs are payroll taxes associated with employee salaries and benefits, including share-based compensation that we are subject to in various countries in which we operate. When the fair market value of our ordinary shares increases on a quarter-to-quarter basis, the accrued expense for social costs will increase, and when the fair market value of ordinary shares falls, the accrued expense will become a reduction in social costs expense, all other things being equal, including the number of vested stock options and exercise price remaining constant. Additionally, approximately 31% of our employees are in Sweden. With respect to our employees in Sweden, we are required to pay a 31.42% tax to the Swedish government on the profit an employee realizes on the exercise of our stock options or the vesting of our restricted stock units.”). CO Rem. Ex. J at 122.

⁹¹ CO Rem. Ex. J at 112, 128; CO Rem. Ex. J at 53 (“The growth in our share price in Q1 significantly increased our operating expenses for the quarter.”); CO Rem. Ex. J at 64 (“The growth in our share price in Q2 increased operating expenses more than plan because of higher social charges.”); CO Rem. Ex. J at 92 (“Operating expenses of €551 million in Q4 increased 80% Y/Y, largely driven by higher than expected social charges resulting from an increase in our share price.”).

⁹² When including the more recent data through Q4 2021 but excluding the additional quarters where Spotify noted that strong stock performance inflated operating expenses (Q4 2020, Q2 2021, and Q4 2021), the average is lower, at 25.9 percent. See Spotify Technology S.A., *Shareholder Letter Q4 2020* (February 3, 2021) at 5, 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2020/q4/Shareholder-Letter-Q4-2020_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q2 2021* (July 28, 2021) at 5, 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q2/Shareholder-Letter-Q2-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q3 2021* (October 27, 2021) at 5, 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q3/Shareholder-Letter-Q3-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q4 2021* (February 2, 2022) at 4, 9 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Shareholder-Letter-Q4-2021_FINAL.pdf).

93 [REDACTED]; however, as shown in Table B-1, Spotify stated in letters to shareholders (also included in the exhibit cited by Professor Marx) that it has been dropping.⁹⁴

**TABLE B-1:
SPOTIFY COMMENTS ON OTHER COST OF REVENUE
IN LETTERS TO SHAREHOLDERS**

Period	Spotify Comments in Letters to Shareholders
Q2 2019	"Gross Margin was 26.0% in Q2, 50 bps above the high end of our guidance range of 23.5-25.5%. The performance was largely driven by better than expected streaming delivery costs as a result of efficiencies driven by usage optimization work , slower than anticipated release of original podcast content, and better than expected royalty margin resulting from slight differences in product and geographic mix."
Q3 2019	"Gross Margin was 25.5% in Q3, 30 bps above the high end of our guidance of 23.2-25.2%.... Similar to the trends we saw develop in Q2, Q3 saw continued efficiencies in streaming delivery and payment expense. "
Q4 2019	"Gross Margin was 25.6% in Q4, toward the high end of our guidance range. The largest driver of outperformance stemmed from slight improvement in the non-royalty component of Gross Margin, including payment fees, streaming delivery costs, and other miscellaneous variances. "
Q1 2020	"Gross Margin finished as 25.5% in Q1 which both exceeded our expectations and finished at the high end of our guidance range," citing " a benefit from non-royalty cost of revenue, most notably streaming delivery costs " as one of the "driver[s] of outperformance."
Q2 2020	"Gross Margin finished at 25.4% in Q2 which both exceeded our expectations and finished above the high end of our guidance range.... We recognized efficiencies in Other CoR [cost of revenue] as streaming delivery costs were slightly more favorable relative to forecast. "
Q3 2020	"Gross Margin finished at 24.8% in Q3, toward the top end of our guidance range. A number of factors drove the positive Gross Margin variance, led by better than forecast non-music content costs and Other Cost of Revenues (e.g. payment fees, streaming delivery costs). "

Source: CO Rem. Ex. J at 64, 77, 92, 107, 121, 137. Note: Spotify's gross margin = (revenue – cost of revenue) / revenue.

⁹³ SPOTRMND006751 (see lines 17-20).

⁹⁴ Spotify also made similar statements in the more recent Q4 2020 through Q4 2021 letters to shareholders. See Spotify Technology S.A., *Shareholder Letter Q4 2020* (February 3, 2021) at 4 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2020/q4/Shareholder-Letter-Q4-2020_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q1 2021* (April 28, 2021) at 4 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q1/Shareholder-Letter-Q1-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q2 2021* (July 28, 2021) at 4 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q2/Shareholder-Letter-Q2-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q3 2021* (October 27, 2021) at 4 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q3/Shareholder-Letter-Q3-2021_FINAL.pdf); Spotify Technology S.A., *Shareholder Letter Q4 2021* (February 2, 2022) at 4 (available at https://s22.q4cdn.com/540910603/files/doc_financials/2021/q4/Shareholder-Letter-Q4-2021_FINAL.pdf).

In Q4 2017 [REDACTED] of revenue.⁹⁵ Even adding this number to [REDACTED] (the average of Q1 2017 through Q3 2020 excluding quarters where it was inflated by strong stock market gains), the resulting non-content cost as a percentage of revenue is [REDACTED] percent. Therefore, even under Professor Marx' incorrect methodology of using non-content costs to calculate a Combined Royalty Rate, more recent data (included in the exhibit Professor Marx cites for Q4 2017 revenue) suggest a rate of at least [REDACTED]. Using the 2.5:1 ratio established in the *Final Determination*, this implies a musical works rate of [REDACTED] percent.⁹⁶ However, as Table B-1 indicates, Spotify has consistently stated on earnings calls that its other costs of revenues have been dropping as a percentage of revenue. Under these corporate disclosures, [REDACTED] percent would be too high, and this analysis again appears to point closer to 30 percent, and thus support the industry standard 70 percent combined royalties rate that I have discussed.

⁹⁵ SPOTRMND006751 ([REDACTED]); CO Rem. Ex. J. at 8 (reporting revenue of approximately €1,149,000,000). [REDACTED] €1,149,000,000 = [REDACTED] percent.

⁹⁶ [REDACTED].

CO Rem. Ex. Y
FILED UNDER SEAL

CO Rem. Ex. Z
FILED UNDER SEAL

CO Rem. Ex. AA
FILED UNDER SEAL

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In re

DETERMINATION OF ROYALTY RATES
AND TERMS FOR MAKING AND
DISTRIBUTING PHONORECORDS
(Phonorecords III)

Docket No. 16–CRB–0003–PR (2018–2022)
(Remand)

**DECLARATION OF BENJAMIN K. SEMEL
REGARDING RESTRICTED INFORMATION**

1. I am a partner at Pryor Cashman LLP, counsel for the National Music Publishers’ Association (“NMPA”) and the Nashville Songwriters Association International (“NSAI” and, together with the NMPA, the “Copyright Owners”) in the above-captioned proceeding (the “Proceeding”).

2. Pursuant to Section IV.A of the Protective Order issued in the above-captioned Proceeding on July 28, 2016 (the “Protective Order”), I submit this declaration in connection with the Copyright Owners’ February 24, 2022 rebuttal submission (the “Additional Materials Rebuttal Submission”) comprised of the following components: (i) Copyright Owners’ Rebuttal Brief Concerning the Additional Materials Orders; (ii) Copyright Owners’ Brief Responding to Judges’ February 9, 2022 *Sua Sponte* Order Regarding Additional Briefing on New Agency Action Question, and Replying to Services’ New Agency Action Arguments in Their Joint Supplemental Brief Addressing the Judges’ Working Proposal; and (iii) Additional Written Rebuttal Testimony of Jeffrey A. Eisenach, Ph.D., with exhibits.

3. I have reviewed Copyright Owners’ Additional Materials Rebuttal Submission. I am also familiar with the definitions and terms set forth in the Protective Order. Each of the

redactions that the Copyright Owners have made to the publicly-filed version of the Additional Materials Rebuttal Submission is necessitated by the designation of that information as “Confidential Information” under the Protective Order by either one of the participants in this proceeding or by a non-party Producing Participant, as that term is defined in the Protective Order, or pursuant to the Order of the Copyright Royalty Judges dated July 20, 2021 in this proceeding (eCRB Docket No. 25481). Because the Copyright Owners are bound under such Orders to treat as “Restricted” and to redact information designated “Confidential Information” by Participants and Producers, they are doing so. Copyright Owners reserve all rights and arguments as to whether any such information is, in fact, “Confidential Information.”

Pursuant to 28 U.S.C. § 1746, I hereby declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information and belief.

Dated: February 24, 2022
New York, New York

/s/ Benjamin K. Semel
Benjamin K. Semel (N.Y. Bar No. 2963445)
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Counsel for Copyright Owners

Proof of Delivery

I hereby certify that on Thursday, February 24, 2022, I provided a true and correct copy of the Additional Materials Rebuttal Submission of Copyright Owners - PUBLIC to the following:

Nashville Songwriters Association International, represented by Benjamin K Semel, served via ESERVICE at Bsemel@pryorcashman.com

Spotify USA Inc., represented by Richard M Assmus, served via ESERVICE at rassmus@mayerbrown.com

Pandora Media, LLC, represented by Benjamin E. Marks, served via ESERVICE at benjamin.marks@weil.com

Google LLC, represented by David P Mattern, served via ESERVICE at dmattern@kslaw.com

Johnson, George, represented by George D Johnson, served via ESERVICE at george@georgejohnson.com

Amazon.com Services LLC, represented by Scott Angstreich, served via ESERVICE at sangstreich@kellogghansen.com

Signed: /s/ Benjamin K Semel